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Ashton for Petitioners.*

Filed Oct. 11, 1897.

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1897.

No. . . 451

THE LACKAWANNA IRON AND COAL COMPANY
Et AL.

versus

THE FARMERS' LOAN AND TRUST COMPANY
Et AL.

BRIEF IN SUPPORT OF APPLICATION FOR A WRIT OF CERTI-
ORARI TO THE UNITED STATES CIRCUIT COURT OF
APPEALS FOR THE FIFTH CIRCUIT.

E. B. KRUTTSCHNITT,
E. H. FARRAR,
B. F. JONAS,
H. T. GURLEY,

*Solicitors and of Counsel for Lackawanna Iron and
Coal Co. and for Pacific Improvement Co.*

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1897.

No.

THE LACKAWANNA IRON AND COAL COMPANY
ET AL.

versus

THE FARMERS' LOAN AND TRUST COMPANY
ET AL.

BRIEF IN SUPPORT OF APPLICATION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT.

We have in a brief, written for the Circuit Court of Appeals, presented a statement of the facts, and of the law of this case, and we have filed the requisite number of copies of this brief with the petition for a writ of *certiorari*. This brief is submitted to your Honors in support of the application for a writ of *certiorari*.

We have, however, thought it well to also present a shorter and more condensed statement of the vital facts of the case with as little detail as possible, said statement to be followed up by a short statement of the propositions of law upon which we rely to obtain the writ.

Before we even state the case, we would say to your Honors that, although the transcript in this cause consists

of 833 printed pages, the whole of the case of the Lackawanna Iron and Coal Company will be found between pages 616 and 687, and that it will be unnecessary for your Honors to trouble yourselves with any other portions of the Record outside of the pages named, except possibly with the Bill of Complaint, and Mortgage or Deed of Trust thereto annexed. (Rec. pp. 8 *et seq.*)

STATEMENT OF CASE.

The Lackawanna Iron and Coal Company is, and has been, since the year 1883, a creditor of the Houston and Texas Central Railway Company, for steel rails furnished to said Company, under contracts, and in order to enable said Company to replace the old iron, with which its tracks were laid, and at a time when the rails were so absolutely necessary, that it was doubtful whether the Company could have maintained its existence as a common carrier without them. Prior to the improvement and repair of the line of road with said rails, accidents to life and limb, and damage to property, were so great, owing to the condition of the tracks of the Company, that the name of said Company became a terror to the traveling and shipping public, and a by-word and reproach. By means of said rails, the railways of the defendant were kept in safe running order, its business and importance increased, and the railway rendered more valuable to the bondholders under the various mortgages, and especially under the mortgage to be hereinafter referred to. The indebtedness for the rails was contracted by the Railway Company in consideration of its promise to pay for the same out of its earnings, and in the expectation and belief that they would be paid for out of the

said earnings; or if the earnings were insufficient, then out of the proceeds of sale of the property itself, by preference over mortgage creditors. The Railway Company, instead of paying the debt so due to petitioner, used a large amount of its earnings for the payment of coupons on bonds secured by its first mortgage.

The rails in question were furnished under two contracts:

(1) Under a contract of date April 26th, 1883, rails were delivered during the months of June, August and September, 1883, for which, pursuant to the terms of the contract, notes were issued in payment, and which were from time to time renewed after partial payments.

Of these rails, a portion was used upon the railways of the Waco and Northwestern Division of the Houston and Texas Central Railway, and upon that portion \$6426.51 remained due on the 16th day of February, 1885.

Certain bonds of the Galveston, Harrisburg and San Antonio Railway Company were pledged as security for this portion of the claim.

(2) Under the second contract, of date October 30th, 1883, rails were delivered during the months of February, March, April and May, 1884, the purchase price of which was evidenced by notes given under the terms of the contract, maturing six months from date of delivery, and which were, by the terms of the contract itself, subject to a right of renewal, which was exercised, so that the notes became due in February, March, April and May, 1885.

Of these rails, an amount worth at the contract price \$99,300.64, were laid upon the railways of the Waco and Northwestern Division. No security whatever was given under this contract.

Prior to the due date of any of the notes, due under the second contract, and to the due date of most of the notes due under the first contract, the railways of the Houston and Texas Central Railway Company, including the Waco and Northwestern Division, were placed in the hands of Receivers, and the railways of the Waco and Northwestern Division have there remained ever since. The Receivership has, however, undergone certain changes and modifications, and we shall now summarize the facts, in relation to such changes and modifications, and also state what net revenues accrued under each Receivership, as follows :

(a) Under a bill filed by the Southern Development Company, in February, 1885, Benjamin G. Clarke and Charles Dillingham were appointed Receivers on the 21st day of February, 1885. This was a bill filed by the Southern Development Company claiming a lien upon the net earnings of the Railway Company and all its property, superior in rank to the mortgage bonds, and was a bill to which mortgage trustees were defendants and not complainants. The bill was filed on behalf of the Southern Development Company in its own behalf and on behalf of all other persons similarly situated. The Lackawanna Company intervened and joined the Southern Development Company. This bill was dismissed on demurrer May 27th, 1886. This Receivership lasted until July 10th, 1886, and under it there was collected from the operations of the Houston and Texas Central Railway Company an amount of \$423,142.16 over and above operating expenses, taxes, etc.

(b) On July 10th, 1886, the old Receivership terminated and a new one was instituted, under which Charles

Dillingham, Nelson S. Easton and James Rintoul were appointed Receivers. This appointment was made in a suit known as Consolidated Cause No. 198, which was a cause wherein the trustees of mortgages upon the various divisions of the Houston and Texas Central Railway Company were complainants, and the Railway Company, itself, a defendant. The Farmers' Loan and Trust Company was a complainant, and filed a bill on behalf of other mortgages which it represented, but although the Court ordered it to stand as a complainant, in Cause No. 198, with leave to file a bill, *it never filed any bill or took any proceedings as trustee of the first mortgage on the Waco and Northwestern Division.* This Receivership lasted, in so far as the property of the whole system was concerned, up to some time subsequent to a sale of the property, and, say, up to some time in the spring of the year 1889, during which time these Receivers spent, outside of operating expenses, an amount of \$1,538,116.38, which, with the exception of a very small sum, either went to the mortgage creditors, or was expended in betterments on the property mortgaged.

In this Cause No. 198, the Lackawanna Company filed its petition of intervention, praying substantially for the same relief for which it prayed in suit No. 185, and for which it prayed in Cause No. 227, to be hereafter referred to.

(c) After the properties of the Houston and Texas Central Railway Company had been sold under final decree in Cause No. 198, in which decree the rights of the Lackawanna Company were expressly reserved for future adjudication, that Company filed its petition in Cause No.

198, asking that the Receivership therein should continue and remain over the property in possession of the Court until its claims should have been finally decreed and passed upon. At the same time the Farmers' Loan and Trust Company, appearing as trustee of the first mortgage of the Waco and Northwestern Division of the Houston and Texas Central Railway, filed its foreclosure bill, known as Bill No. 227, under which it obtained an order appointing a receiver of the Waco and Northwestern Division, who was the same receiver already in charge of the Houston and Texas Central lines. The filing of this bill April 6th, 1889, was the first attempt by the trustee to enforce its rights upon either *corpus* or income of the mortgaged property.

During the Receivership in Cause No. 198, interest was paid, by order of the Court, to holders of first mortgage bonds of the Waco and Northwestern Division, aggregating in amount \$91,371, under orders expressly rendered, "without prejudice to the rights of defendant or any intervenor in this cause, or any final decree to be rendered in the same, nothing herein being decided as to the merits of the claim of the defendants, or of intervenors, and this order not in any manner stopping or affecting the rights of any party or intervenors in this cause."

It is also shown that during the years 1883 and 1884, whilst the rails sold by the Lackawanna Company were being by it delivered to the Houston and Texas Central Railway Company, that Company paid out \$2,386,400 in interest on bonded indebtedness, whereof about \$1,300,000

was paid from income or current earnings, and out of which amount \$159,600 was paid as interest on the first mortgage bonds of the Waco and Northwestern Division. These interest payments were made out of the very monies which should have paid the Lackawanna claim.

Upon these facts we claim that the debt due the Lackawanna Company is clearly one entitled to an equitable lien upon earnings under the rule in *Fosdick vs. Schall*, and the other cases which followed that one.

In the brief which we filed in the Circuit Court of Appeals, and which is also filed here, the authorities are given at length; but the cases most similar to the one at bar are the cases of *Hale vs. Frost*, 99 U. S. 391, in which case Hale, Ayer & Company recovered upon a claim which extended back to a date long prior to August, 1873, for an amount which had been repeatedly evidenced by notes, upon which payments had been made and new notes given, and yet recovery was had in a Receivership instituted May 19th, 1875. And in *Burnham vs. Bowen*, 111 U. S. 777, the claim was for "monthly settlements of monthly accounts with a somewhat extended credit." In other words, just such a claim as that of the Lackawanna Company.

The only rule that we have been able to find, which has been sanctioned by your Honors is, that each case is to be decided upon its own merits, and that all claims of the nature allowed as liens enjoying priority over the mortgages must have been incurred within a reasonable time prior to the Receivership. Inasmuch as the allowance of a claim of the character of the one set up by the Lacka-

wanna Company is one resting so largely in the discretion of the Chancellor, it becomes important to show the nature of conflicting claims upon the revenues of the defendant Railway Company, because if no conflicting claims existed, or if the conflicting claims be of a character not commending themselves to the Chancellor, they may be disregarded in the exercise of the judicial discretion allowed in such cases.

That the mortgagees, under this mortgage, had no mortgage upon income, is seen from a mere inspection of their mortgage. (Rec. pp. 22 *et seq.*) Even if they had a mortgage upon income, such mortgage would have given them no lien upon the earnings of the road whilst it remained in the hands of the Company, nor until the trustee should take some steps, authorized by the mortgage, to appropriate the earnings. Especially is this the case where the effect of the mortgage of real property is not deemed a conveyance so as to enable the mortgagee to recover possession of the real property without a foreclosure and sale, according to law, and Texas is one of the States where it has been decided that a mortgage is a mere security for the payment of a debt, and that the mortgagee cannot sustain an action of ejectment against the mortgagor.

By the terms of the mortgage sued upon in this cause, the Railway Company was to remain in possession of its property, and had the right to operate the same and appropriate earnings and income until default, continuing for the time stipulated in the mortgage, in which event the trustee was empowered to take possession of the railroad

and operate it, applying net earnings to the satisfaction of interest. The trustee not only failed to take possession of the road, but never, until it filed its foreclosure bill in Cause No. 227, on the 6th day of April, 1889, took any steps whatsoever to assert any lien upon the earnings.

We therefore respectfully submit :

I.

That the claim of the Lackawanna Iron and Coal Company is one of the character repeatedly recognized by this Court as a charge in equity on the income of a railway company both prior to and during a receivership.

II.

That the Farmers' Loan and Trust Company, and the beneficiaries under its trust, had no lien upon any earnings of the Waco and Northwestern Division of the Houston and Texas Central Railway Company prior to April 6, 1889, and the Circuit Court having appropriated those earnings to payment of interest on the bonds represented by said Trust Company, as also to improving the property mortgaged, will now restore to the current income fund the amount diverted from it to the prejudice of current income creditors.

That we are not entirely alone in our belief that the judgment of the Circuit Court of Appeals is incorrect upon these questions will be seen from the following editorial notice of its decision in the *American Law Review*, for July and August, 1897, pages 611 and 612 :

“RAILROAD RECEIVERSHIPS: PREFERENTIAL DEBTS—WHEN PURCHASE OF RAILS NOT PREFERRED BEFORE LIEN OF PRIOR MORTGAGE.—In the case of *Lackawanna, etc., Co.*

vs. Farmers' Loan, etc., Co., lately decided in the Federal Circuit Court of Appeals for the Fifth Circuit, it is held that the purchase by a railroad company, under contracts made from about sixteen months to over two years before the appointment of a receiver, of some 20,000 tons of steel rails, to replace the old and deteriorated rails with which its tracks were laid, to be paid for by its notes, due in six months, renewable for six months longer at the railroad company's option, is not a purchase of supplies in the ordinary operation of the road to keep it a going concern, so as to authorize the court appointing the receiver to give the debt a preference over the mortgage debt. The Court of Appeals which decided this case consisted of three District Judges. The opinion of the court is written by Mr. District Judge Parlange. It reviews a good many of the decisions upon this subject, but not all of them. It is believed to be unsound. There is one case which has held the debt to partake of a preferential quality, although it is six years old." (*Union Trust Co. vs. Morrison*, 125 U. S. 591, 604). "Another gives it that quality where it was nearly five years old." (*Northern, etc., R. R. Co. vs. Lamont*, 69 Fed. Rep. 93). "If the reconstructing of a railroad track with steel rails so that it may be operated with safety to the public is not necessary to keep it a going concern, within the well-known rule upon this subject, what is?"

THE GROUNDS UPON WHICH THE WRIT OF CERTIORARI SHOULD ISSUE.

We respectfully submit that your Honors have never yet, in any case, directly passed upon the questions constituting the distinguishing features of this case, and controlling its correct decision.

Within a very few weeks from this date a cause will, in due course of judicial proceeding, be reached upon your calendar, wherein the full and exact scope and extent of the doctrine, announced in the case of *Fosdick vs. Schall*,

will be submitted to you for adjudication, in a case wherein you have heretofore issued a writ of *certiorari* to the Circuit Court of Appeals for the Fifth Circuit, to-wit., the case of *Rowena M. Clark et al. vs. The Central Railroad and Banking Company of Georgia et al.*, No. 100 of your Docket, for the October Term, 1897.

Your Honors have also granted a *certiorari* in the case entitled *Southern Railway Company vs. Carnegie Steel Company, Limited*, which cause is numbered 278 upon the Docket of this Court, for the October Term, 1897.

Not only will the whole doctrine, governing this cause, be the subject-matter of review and adjudication, in the two causes above-named, but in the last named case the Circuit Court of Appeals for the Fourth Circuit decided a cause which is, as to nearly every crucial fact, an exact duplicate of the cause now presented to your Honors in this petition, and which is its exact duplicate in law. The decision of the Fourth Circuit was in diametrical opposition to the decision in the Fifth Circuit.

The decision by this Honorable Court, in the case of the *Southern Railway Company vs. The Carnegie Steel Company, Limited*, will be absolutely decisive of this cause; provided the mandate of the Circuit Court of Appeals for the Fifth Circuit be stayed herein until the *Southern Railway Company* cause is reached by your Honors.

Under these circumstances, we respectfully submit that the importance of the questions involved in this cause, which are all questions of general jurisprudence; the fact that a similar cause has already been ordered to be certified by your Honors from another Circuit; the propriety of maintaining a uniformity of jurisprudence between differ-

ent Courts of Appeal; and the manifest hardship and wrong which will have been done to petitioners in this cause, if your Honors should leave them remediless and thereafter affirm the decision of the Circuit Court of Appeals for the Fourth Circuit, should be absolutely conclusive upon our right to the writ of *certiorari*. We have a right to have the decision in our cause stayed until this Honorable Court, which has become seized of all the questions of law, involved in it, shall have passed upon them, whether your decision be favorable or adverse to us.

Although we lay before you the full briefs submitted by us to the Circuit Court of Appeals, we, nevertheless, submit that your Honors will not, upon the present application, examine into, or decide either favorably or adversely to us, the questions involved in this case, and especially the one first stated above. You have, by granting the writ in the Southern Railway case, decided that that question is of such a nature that it should be reviewed by you. A decision, adverse to us upon this application, would, under the circumstances of this case, practically adjudicate questions of which you have taken jurisdiction, and upon which you will adjudicate only after full argument, and in due course of judicial proceedings. The identity of the issues, or of some of the issues, involved in this cause, with the issues, or with some of the issues, involved in the Southern Railway cause, being assumed and proved, the right to the writ of *certiorari* would seem to us to follow as a matter of course, reserving until a future time the correct exposition by this Court of the law applicable to this case.

No serious hardship can inure to the respondents, even if the final decision should be against us, for the reason

170. 451. No. 22

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Filed Dec. 11, 1897.

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JAMES H. MCKENNE

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1897.

No. 451.

THE LACKAWANNA IRON AND COAL COMPANY
ET AL., PETITIONERS,

versus

THE FARMERS' LOAN AND TRUST COMPANY
ET AL., RESPONDENTS.

COPY OF BRIEF FILED IN CIRCUIT COURT OF APPEALS, NOW
FILED IN SUPREME COURT IN SUPPORT OF APPLICA-
TION FOR WRIT OF CERTIORARI.

E. B. KRUTTSCHNITT,
E. H. FARRAR,
B. F. JONAS,
H. T. GURLEY,

*Solicitors and of Counsel for Lackawanna Iron and
Coal Co. and for Pacific Improvement Co.*

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UNITED STATES CIRCUIT COURT OF APPEALS

FIFTH CIRCUIT.

No. 503.

LACKAWANNA IRON AND COAL COMPANY Et
AL., APPELLANTS,

versus

FARMERS' LOAN AND TRUST COMPANY Et AL.,
APPELLEES.

On the 6th day of April, 1889, the Farmers' Loan and Trust Company, as complainant, filed a Bill of Complaint against the Houston and Texas Central Railway Company et als., seeking the foreclosure of a mortgage granted by the latter Company upon the division of its railways, known as the Waco and Northwestern Division. (Rec. pp. 8 *et seq.*)

In this proceeding the Lackawanna Iron and Coal Company filed a petition of intervention, the object of which petition was to obtain the recognition of an indebtedness due to it by the Houston and Texas Central Railway Company, which indebtedness had been represented by twenty-five promissory notes, maturing at different dates, in the first five months of the year 1885, and aggregating a total of \$445,175.50, and which indebtedness had been liquidated by a judgment of the District Court of Dallas

County, in the State of Texas, at the sum of \$555,914.25, with interest at eight per cent. per annum from May 17th, 1889.

These notes had been given in evidence of the purchase price of certain steel rails bought by the Houston and Texas Central Railway Company from the Lackawanna Iron and Coal Company, under circumstances described in the tenth paragraph of the petition (Rec. pp. 620-622), as follows :

"That all of said steel rails so delivered were used for the useful improvements and necessary repair of the main line of said Houston and Texas Central Railway Co., and of the western division thereof, and of the Waco and North-western division thereof, to the extent hereinafter more fully set forth. That said steel rails were so absolutely necessary to said Company to enable it to replace the old iron with which its tracks were laid, that it is doubtful whether said Company could have maintained its existence as a common carrier without them. That prior to the improvement and repair of said line of road with steel rails, as aforesaid, accidents to life and limb and damage to property was so great, owing to the condition of the tracks of said Company, that the name of the Houston and Texas Central Railway Company became a terror to the traveling and shipping public, and a by-word and reproach. That, by means of said steel rails so furnished by petitioner to said defendant railway, the railway of said defendant Company has been kept in safe running order, its business and importance increased, and said railway thereby rendered more valuable to the bondholders under the various mortgages thereupon, and especially to the bondholders under the deed of trust and mortgage held by complainant herein, and upon which its bill of foreclosure has been filed in this cause. That said indebtedness was contracted by defendant in consideration of its promise to pay the same out of the earnings of its railway. That your peti-

tioner made the contracts aforesaid, and furnished the steel rails aforesaid, under the expectation and belief that it would be paid for the same out of the revenues and earnings of said property; and that in case said revenues should not be sufficient, out of the proceeds of the sale thereof, by preference over any of the holders of mortgage bonds secured by deeds of trust on said property, but that said defendant, instead of paying the debt so justly due to your petitioner, out of the earnings of said railway, has entirely failed to pay the same, or any part thereof, as hereinabove set forth, and that the truth is, and your petitioner so charges, that the said defendant has used a large amount of said earnings for the payment of coupons upon bonds secured by the mortgage upon which a bill of foreclosure has herein been filed, although the holders of said coupons were only entitled to receive payment thereof after the defendant had paid your petitioner the amounts advanced and expended in the manner and for the purposes hereinabove set forth. That said steel rails so purchased by said Railway Company were actually used for the betterment and improvement of its railway aforesaid, and not for purposes of construction, and that the said rails have been an increment to the value of the property mortgaged to said bondholders, and that your petitioner has the right to claim and does claim that the revenues of said railway property should be applied to the payment of petitioner's said indebtedness, by preference over the claim of any bondholders or coupon holders, whomsoever."

The petition (R. pp. 623, *et seq.*) asked that an account might be taken, under the direction of the Court, as to the dates and amounts of money paid by the defendant Railway Company to any of the mortgagees in the various trust deeds, described in the petition, showing particularly the issue of bonds upon which such interest was paid; and what proportion of the amounts so paid were paid out of current revenues of the Company, in the absence of earn-

ings, and what amounts were so paid out of net earnings of the defendant Railway Company; and particularly so as to show what amounts and proportions were so paid out of the net earnings of those portions of the railway of the defendant Railway Company, described in the Bill of Complaint of the Farmers' Loan and Trust Company, hereinabove referred to; that an account might be taken showing the proportion of steel rails furnished by petitioner to the defendant Railway Company, used upon the railways described in the Bill of Complaint; and that the account to be taken should also show all receipts and expenditures made by the Receivers, in whose hands the property had been placed under proceedings which will be hereinafter at greater length detailed, and which account should be taken in such manner as to show the dates when the expenditures were made, and the character of the expenditures, and in such manner as to show whether the expenditures were made for operating and running expenses, or for extraordinary repairs, betterments and improvements of the property, and for the payment of fixed charges upon the same.

The petition further prayed that for the amounts due on such accounting to petitioner and equitably chargeable upon the railways described in the Bill of Complaint in said cause, there might be a decree against the defendant Railway Company, and against all of the parties complainant and defendant, decreeing the sum so due to be liens upon the net earnings of the Railway Company, and especially upon those portions of said net earnings which have accrued or may accrue from the railways described in the Bill of Complaint, both those accrued prior to the Receivership in

Cause No. 185, and those accrued and to accrue during the Receivership in Cause No. 198; and upon all of the property of the Railway Company, superior in rank to the claims of the trustee and of the holders of mortgage bonds and coupons issued under the deed of trust sought to be foreclosed by the Farmers' Loan and Trust Company; that the net earnings of the railway described in the Bill of Complaint should be first devoted to the payment of the accounts so decreed, and, if they should prove insufficient to pay the amounts, then that the Court should decree the payment of said amounts out of any proceeds of sale of the property of the defendant Railway Company to be made under final decree.

The Pacific Improvement Company, as assignee of the Lackawanna Company, was, by order of Court, and upon its petition, made a co-petitioner with the Lackawanna Company. (R. p. 646.)

This petition, with the answers of the Farmers' Loan and Trust Company, and of Moran Bros. et als., intervening bondholders (R. pp. 635 and 647), was referred to William L. Prather as a special master "to take the accounts prayed for, and to investigate, find and report upon the facts as to the subject matter of said petition, and of the answers thereto."

Under this petition facts were found, which will be found in the record, pp. 648 *et seq.*, from which we extract the crucial facts, and now state them as follows:

On the 28th day of December, 1882 (R. p. 650), the Lackawanna Iron and Coal Company entered into a written agreement with the Houston and Texas Central Railway Company, under which five thousand and twenty (5020) tons

of 56 lb steel rails were furnished to said Railway Company in the months of February, March, April and May, 1883, which rails were, in due course of time, paid for, and this contract is wholly immaterial to the issues before the Court, and is referred to merely as a fact in the history of this litigation, the non-statement of which might hereafter lead to some confusion.

On the 26th day of April, 1883, the said Lackawanna Company entered into another contract, in writing, with the Houston and Texas Central Railway Company, pursuant to which contract it delivered to said Railway Company five thousand and nine (5009) tons of 56 lb steel rails during the months of June, August and September, 1883, at the price of \$39.50 per ton. Pursuant to the terms of the contract, notes were issued in payment of these rails, aggregating in amount, with interest to their maturities, \$201,346.64; but which notes were from time to time renewed until they were reduced to eight in number, maturing at dates between January 20th, 1885, and April 24th, 1885, and aggregating in amount \$118,000. (R. pp. 651-2).

It is shown that 6.2 miles of the railway of the Waco and Northwestern Division of the Houston and Texas Central Railway were laid with rails furnished under the two contracts above described, but it was not shown what proportion of rails were furnished under each of the two contracts. (R. p. 655). As it is further shown that the Waco and Northwestern Division was run as a part of the system of railways belonging to the Houston and Texas Central Railway, and as it is impossible to separate the accounts of that division whilst it was in the possession of the Houston and Texas Central Railway from the accounts of the rest of the

system, it is only fair and equitable to assume that the rails furnished under the two contracts, which were about equal in amount, were divided about equally upon this 6.2 miles, which would give 3.1 miles laid with the rails furnished under the second contract.

The original contract price of the 5009 tons of rails was \$197,855.50, which was reduced by payments to \$118,000, as aforesaid. A simple calculation will show that upon 3.1 miles of road 272.8 tons of rail were required, because it requires 88 tons of 56 lb rails to lay one mile of road. (R. p. 655). And these rails, at the contract price of \$39.50 per ton, were worth \$10,775.60. If we pro-rate the payments made upon the contract, this indebtedness will be reduced to \$6,426.51, which represents the amount of rails furnished by the Lackawanna Company under the second contract to the defendant Railway Company, and used upon the roads of the Waco and Northwestern Division.

Under a third contract entered into between the Lackawanna Company and the defendant Railway Company on the 30th day of October, 1883, the Lackawanna Company delivered to the defendant Company 8552 tons of 54 lb steel rails during the months of February, March, April and May, 1884, the purchase price of which rails, evidenced by promissory notes maturing at different dates during the months of February, March, April and May, 1895, amounting to \$327,175.50. (R. pp. 653-4).

Of these rails it is shown that 30.8 miles were consumed upon the railways of the Waco and Northwestern Division of the Houston and Texas Central Railway. The contract price of the rails was \$36.60 per ton, and as it requires 84.86 tons of 54 pound rails to lay one mile of track, it fol-

lows that the value of the rails at the contract price was \$99,300.64. (R. pp. 655-6).

It therefore appears that there is still due upon the purchase price of rails furnished under the second contract, and laid upon the railways of the Waco and Northwestern Division of the Houston and Texas Central Railway a sum total of \$6426.61, and of the rails furnished under the third contract the whole purchase price is due, amounting, in so far as the Waco and Northwestern Division is concerned, to the sum of \$99,300.64 as aforesaid.

At the time when the Lackawanna Company made the contracts and furnished the rails in question, the condition of the track of the defendant Company was such that the demand for new rails upon the most worn portion of the same was practically imperative. For a number of years prior to December, 1882, only about 5000 tons of new rails had been purchased. The road north, from Houston, for 90 miles, was completed between 1857 and 1861, and thence northward to Denison between 1867 and 1872. The Waco Division was completed about 1875. The condition of the road was bad. There was continual breakage of rails and wreckage of trains; the track was unsafe, and was generally so regarded not only by railroad men, but by the traveling public; the damage to merchandise, rolling stock, etc., was continuous, and the need for new rails was absolutely necessary as a preservation of human life, the loss of which was liable to occur at any moment. Both buyer and seller expected the rails to be paid from the net income of the railway. The sale was made without any stipulation for security to be given by the defendant Com-

pany, or for payment out of any particular fund, or in any particular way. (R. pp. 656-7).

The rails supplied under these contracts were laid in the tracks of the defendant Railway Company as above stated. (R. p. 657). Within nine months after the last of these rails were delivered a Bill of Complaint was filed in the United States Circuit Court for the Eastern District of Texas by the Southern Development Company, praying, among other things, for the appointment of Receivers to the railways of the Houston and Texas Central Railway Company. (R. pp. 653 and 658).

Upon this bill, Benjamin G. Clarke and Charles Dillingham were appointed Receivers on the 21st day of February, 1885. This bill was filed by the Southern Development Company, seeking a marshaling of the assets of the defendant Corporation, and a declaration that its claim was secured by a lien upon the net earnings of the Railway Company, and upon all of its property, superior in rank to the mortgage bonds. This bill was filed by the Southern Development Company in its own behalf, and in behalf of all other persons similarly situated, who might intervene to protect their own interests. The Lackawanna Company did intervene, praying substantially for the same relief as is prayed for by its intervention in this cause. (Rec. pp. 659-668).

The Bill of Complaint of the Southern Development Company was, on the 27th day of May, 1886, dismissed upon demurrer, without prejudice to the rights of complainants to assert their claims, if any they had, in such manner as they might be advised; but prior to the dismissal of said bill, Nelson S. Easton, James Rintoul, and

Charles Dillingham were appointed Receivers of the properties of the defendant Railway Company, under three bills filed by various mortgage creditors, and which bills are generally known as Bills Nos. 198, 199 and 201 of the Chancery Docket of the Circuit Court of the United States for the Eastern District of Texas. (R. p. 662).

Clark and Dillingham, Receivers, turned over all the property in their possession to Easton, Rintoul and Dillingham, as Receivers, on the 10th of July, 1886, and these Receivers remained in possession of the property until December 7th, 1886, or thereabouts, when Easton and Rintoul were relieved from further duty, and Dillingham continued as sole Receiver. (R. 663).

The mortgages declared upon in the Causes Nos. 198, 199 and 201 were foreclosed by final decree entered in Consolidated Cause No. 198, under which number the three causes, together with others, had been consolidated, and under this decree all the property of the Railway Company was sold on the 8th of September, 1888, including the property of the Waco and Northwestern Division of the Houston and Texas Central Railway, which property, however, was sold subject to the mortgage forming the subject matter of the bill of foreclosure of the Farmers' Loan and Trust Company, filed under the No. 227 of the docket of the United States Circuit Court for the Eastern District of Texas, and subject, also, to the right which the Court reserved by its decree to charge upon the property, or any part thereof, the payment of any amount that might be found to be due and payable by reason of intervening petitions theretofore filed in said cause, and to be entitled to

priority over the mortgage debts referred to in the decree. (R. p. 663).

The Lackawanna Company filed its petition of intervention in said Cause No. 198, praying substantially for the same relief as it had prayed for in its petition in Cause No. 185, and praying substantially for the same relief as it prays for in its petition of intervention in Cause No. 227. (R. p. 616 *et seq.*)

Subsequently to the decree in said Cause No. 198 and to the sale made thereunder, the Lackawanna Company, on the 20th day of April, 1889, filed its petition in said Cause No. 198, asking that the Receivership therein should continue and remain over the property then in the possession of the Court, being the property now in the hands of the Receiver in this cause, until the claims and demands of the Lackawanna Company should have been finally decreed upon, and, if decreed in its favor, should have been finally paid and settled; and, further, praying the Court to render a preliminary order staying the order which had theretofore been rendered, directing the delivery of the property to one George E. Downs, who had become the purchaser thereof, and directing the Receivers not to deliver the property to any purchaser until after the final hearing of the matter of said petition. (R. p. 675).

On this petition an order was rendered directing Downs and the Farmers' Loan and Trust Company to show cause why the relief prayed for should not be granted; and further directing the Receiver to retain possession of the property until the further order of the Court; and further ordering that the Receivership which had theretofore been ordered in Cause No. 227 should be concurrent with the

original Receivership ordered in Cause No. 198, and that the Receiver should keep separate accounts of the earnings and expenses of the Waco and Northwestern Division of the Houston and Texas Central Railway Company. (R. p. 675).

It will thus be seen that ever since the Lackawanna Company filed its intervention in Cause No. 185, on the the 12th day of September, 1885, the Lackawanna Company has at all times had an intervention pending in the matter of the Receivership of the Waco and Northwestern Division of the Houston and Texas Central Railway Company in every phase which that litigation has assumed. It will be seen that the Receivership ordered in Cause No. 198 has been continued concurrently with the Receivership in Cause No. 227, down to the present day. Thus, any intimation of laches, or of sleeping upon rights, is conclusively disproved, in so far as the conduct of the Lackawanna Company, itself, is concerned.

It now behooves us to further show the conduct of the complainant, the Farmers' Loan and Trust Company, as Trustee of the first mortgage upon the Waco and Northwestern Division of the Houston and Texas Central Railway; to show the use made of the revenues of that division for the benefit of the first mortgage bondholders, and to show that in every order rendered in favor of those bondholders, they allowed a clause to be inserted providing that the order was rendered without prejudice to the rights of the defendant, or of any intervenor in the cause, and with express reservation of such rights.

We descend to particulars :

We have heretofore shown that the Southern Development Company filed its Bill in suit No. 185 of the docket of the United States Circuit Court for the Eastern District of Texas on the 16th day of February, 1885. It filed an Amended and Supplemental Bill, on the 20th day of February, 1885, after the appointment of Receivers. Prior to the filing of this Amended Bill, on March 31, 1885, the Farmers' Loan and Trust Company filed its petition in said Cause No. 185, praying to be made a party thereto, averring among other things that it was trustee under several different mortgages executed by the defendant Railway Company, and naming among others the mortgage sued upon in Cause No. 227. The prayer of the petition was granted on April 6, 1885; the Farmers' Loan and Trust Company was allowed to become a defendant in said suit No. 185, with a proviso that it might demur, plead or answer on or before the Rule Day in June, 1885. On June 15, 1885, pursuant to this leave, the Farmers' Loan and Trust Company answered both the Original and Supplemental Bill of the Complainant. An inspection of this answer will show, and the Master finds, that its averments are all defensive, and that this answer, with the petition praying to be made a party defendant, are the only pleadings and appearance made by the Farmers' Loan and Trust Company in Cause No. 185. and that it does not appear from said answer that the Farmers' Loan and Trust Company, as trustee for any of the mortgages mentioned in said answer, either demanded of the Court that the Receiver should hold the property for said trustee, or in any other manner demanded affirmative relief under any of

the mortgages under which it was a trustee. (R. pp. 671-2). Its appearance in said Cause No. 185 was simply that of a defendant, in opposition to the rights asserted in the original and supplemental bill of complaint.

We have already seen above that the bill in Cause No. 185 was dismissed upon demurrers, which demurrers were filed on October 5th, 1885, by Easton and Rintoul, Trustees, under different mortgages. This dismissal occurred May 27th, 1886 (R. p. 672); but on May 26th, 1886, prior to the entry of the order of dismissal, on motion of the defendant, the Houston and Texas Central Railway Company, an order was rendered in six causes, numbered respectively 183, 184, 188, 198, 199 and 201. This order was rendered upon consent of all parties in open Court. It first provided that no further proceedings should be had in Causes Nos. 183, 184 and 188, without notice to the defendant Railway Company. It further provided that Causes Nos. 198, 199 and 201 should be consolidated under the No. 198, and under the name and style of Nelson S. Easton and James Rintoul, Trustees, and the Farmers' Loan and Trust Company, Trustee, against the Houston and Texas Central Railway Company and Benjamin A. Shepard, Trustee, Consolidated Cause; that in said cause Easton and Rintoul should stand as complainants, as trustees under the mortgages or deeds of trust made by the defendant Railway Company, and bearing date respectively July 1st, 1886, and December 21st, 1870; that the Farmers' Loan and Trust Company, expressly assenting thereto, should stand as complainant under the mortgages or deeds of trust made by the defendant Railway Company, bearing dates respectively June 16th, 1873, October 1st, 1875, and April 1st, 1881, and that

Benjamin A. Shepard should stand as defendant, as trustee under the mortgage or deed of trust made by the defendant Railway Company, bearing date May 7th, 1877; that the bills filed in said Causes Nos. 198, 199 and 201 should stand as bills in the Consolidated Cause, and might be amended by either complainant, as they might be advised, by the August Rule Day, and that any party might file an answer to such original or amended bills as he might be advised within thirty days after said August Rule Day. No other action was taken in Causes Nos. 183, 184 and 188, after the order above mentioned, and it is unnecessary to further allude to them. Consolidated Cause No. 198 proceeded to final decree, and the three mortgages declared on therein were in all things foreclosed. (R. p. 673).

The Farmers' Loan and Trust Company, Trustee, in the mortgage declared upon in Cause No. 227, expressly assented to stand as complainant in said Cause No. 198, but filed no Bill of Complaint therein, and the Bill of Complaint in Cause No. 227 was not filed until long after final decree in Cause No. 198.

On March 21st, 1887, the Farmers' Loan and Trust Company filed an answer to the petition of Nelson S. Easton and James Rintoul in Cause No. 198, wherein and whereby the Farmers' Loan and Trust Company, as Trustee, under the Waco and Northwestern First Mortgage, being the mortgage forming the subject matter of the foreclosure proceedings now before this Court (under the No. 227), prayed the Court that any order which should be rendered in Cause No. 198, directing the payment by the Receivers out of the surplus of net earnings in their hands of any coupons falling due under any of the trust deeds by said

Railway Company, might order and provide for payment by the Receivers out of the surplus of net earnings in their hands of the two coupons due under the Waco and Northwestern Division first mortgage, as well as under the said other first mortgages. (R. p. 673).

The application of Easton and Rintoul, as also the application of the Farmers' Loan and Trust Company, for the payment of interest coupons, on the bonds secured by first mortgages or deeds of trust, described in the Bills of Complaint in said Consolidated Cause, came on to be heard on the 27th day of April, 1887, when an order was rendered by the United States Circuit Court for the Eastern District of Texas, that the coupons due January 1, 1885, and July 1, 1885, upon the first mortgage bonds of the Waco and Northwestern Division of the Houston and Texas Central Railway should be paid, with interest upon said coupons, due January 1, 1885, from January 1, 1885, until May 1, 1887, at the rate of six per cent. per annum, and with interest upon one-half of the coupon due July 1, 1885, from said last-named date until May 1, 1887, when the same was ordered to be paid, and upon the remaining one-half of said coupon until it should have been paid. The two coupons were paid pursuant to this order. The order expressly declared that it was :

"Without prejudice to the rights of defendant or any intervenor in this cause, or any final decree to be rendered in the same, nothing herein being decided as to the merits of the claim of the defendants, or of intervenors, and this order not in any manner stopping or affecting the rights of any party or intervenors in this cause."

The Farmers' Loan and Trust Company, as Trustee upon this same first mortgage of the Waco and Northwestern

Division, also filed petitions in the United States Circuit Court for the Eastern District of Texas, on the 6th day of November, 1888, and on the 20th day of November, 1888, for payment of the remaining coupon interest due upon the first mortgage of the Waco and Northwestern Division, upon which petitions no order was ever rendered.

By the final decree, rendered in Cause No. 198 on the 4th day of May, 1888, foreclosing the various mortgages sought to be foreclosed in said cause, the United States Circuit Court for the Eastern District of Texas expressly reserved the right to charge the property, under said decree ordered to be sold, with any amounts that it might decree in favor of any interventions then on file, and the intervention of the Lackawanna Company was on file at the time of said decree. (R. p. 674).

The amount of interest paid to holders of first mortgage bonds of the Waco and Northwestern Division, under the orders of Court above referred to, including the interest paid pursuant to said orders, amount to \$91,371. (R. p. 680).

This statement of facts is necessarily lengthy, and we now pause, in order to give a briefer and more condensed statement, to which we shall add a few other facts, not requiring any great space for their statement, nor any great amount of explanation.

1st. The Houston and Texas Central Railway Company owes the Lackawanna Iron and Coal Company the sum of \$6426.51, exclusive of interest and costs, for rails supplied by the Lackawanna Company to the Railway Company, under the second of the above described contracts, and used upon the Waco and Northwestern Division.

2d. The Houston and Texas Central Railway Company

owes the Lackawanna Iron and Coal Company the sum of \$99,300.64, contract price of rails furnished under the third of the above contracts to the Houston and Texas Central Railway Company, and used upon the Waco and North-western Division of that Company.

3d. These rails were furnished at a time when they were absolutely necessary, in order to maintain the existence of this portion of the system of the Houston and Texas Central Railway Company as a going concern; by their use the railway of the defendant Company was kept in safe running order, its business increased, and its railway thereby rendered more valuable to the bondholders under the various mortgages thereupon, and especially to the bondholders under the deed of trust and mortgage sought to be foreclosed in the proceedings now before the Court. The contracts were made, and the rails furnished under the expectation and belief that they would be paid for out of the revenues and earnings of the property, and if these were insufficient, out of the proceeds of sale thereof, but the defendant, instead of paying the debt due to the Lackawanna Company out of the said earnings, used the earnings for the purpose of paying coupons upon bonds secured by mortgage, upon which bonds the bill of foreclosure, now before the Court, was filed. The holders of these coupons were only entitled to receive payment after defendant had paid petitioner the amounts advanced and expended for the purchase of steel rails. The rails were actually used for the betterment and improvement of the railway, and not for the purposes of construction.

4th. Whilst the property of the defendant corpora-

tion was in the custody of the United States Circuit Court for the Eastern District of Texas, and before any proceedings whatsoever had been taken to impound the revenues of the defendant, or to affect them with any right whatsoever in favor of the bondholders, by order of said United States Circuit Court, an amount of \$91,371, out of the revenues of the railways of the Houston and Texas Central Railway Company, were paid to the holders of the bonds forming the subject matter of the foreclosure proceedings now before this Court for review.

5th. Whilst the property in question was thus in the custody of the United States Circuit Court for the Eastern District of Texas, its Receivers sold the rails removed from those portions of the Waco and Northwestern Division, upon which the new steel rails furnished by the intervening petitioner were laid; 2960 tons of such old rails were removed from the 37 miles laid with new steel rails, and were sold at a price of \$13 per ton net. This would give a salvage of \$32,032 from the sale of old material removed from the 30.8 miles of road, upon which new rails, furnished under the third contract, were laid, and \$3224 as the salvage through sale of old rails taken from the 3.1 miles laid with rails furnished under the second contract. (R. p. 656).

6th. During the years 1883 and 1884, whilst the rails in question were being furnished, the Houston and Texas Central Railway Company paid out \$2,386,400 in interest upon its bonded indebtedness, which amount, less \$1,043,198.27, which was borrowed for interest purposes, in those years, was presumably paid from income or current earnings. Out of this amount \$159,600 was paid as

interest on the first mortgage bonds of the Waco and Northwestern Division, being the bonds forming the subject matter of the Bill of Complaint in Cause No. 227. (R. p. 676).

7th. During the Receivership of Clarke and Dillingham, in Cause No. 185, they received from the operations of the railway of the defendant Company a total of. . . \$4,902,218 45
 Their expenditures for operating expenses, taxes, etc., for the same period, amounted to. . . 3,479,076 29

Leaving a net balance from the operations of the railways of the Houston and Texas Central Railway Company, from February 23, 1885, to July 10, 1886, in cash, of. \$ 423,142 16

See figures (Rec. p. 666), which we have consolidated as above.

8th. Clarke and Dillingham collected from assets of the defendant Railroad Company, consisting of traffic balances, sales of old rails and old cars, a sum total of. \$265,921 42
 (R. p. 667).

Easton, Rintoul and Dillingham, from the same source, collected. 135,889 70
 (R. p. 668).

Total. \$401,811 12

9th. The Receivers, in Suits Nos. 185 and 198, Clarke, Dillingham, Easton and Rintoul, during their administration, expended a sum total of \$1,538,116.38 outside of operating expenses, all of which, except the sum of \$23,274.20, clearly went into the pockets of the mortgage creditors, or were expended in betterments upon the properties mortgaged

to them. In other words, a total of \$1,512,842.18 inured out of the revenues of the Receivership to the benefit of the mortgage creditors. (Rec. p. 667).

10th. The accounts of the defendant Railway Company were not kept in such a manner as to distinguish between earnings and expenses on the Waco and Northwestern Division, and those derived from the other divisions of defendant Company's Railway. (Rec. p. 680).

11th. The properties mortgaged to the Farmers' Loan and Trust Company, under the mortgages sought to be foreclosed in this cause, were the lines of the Houston and Texas Central Railway from Bremond to Ross, commonly known as the Waco and Northwestern Division, extending a distance of fifty-eight miles, whilst all the roads of the defendant corporation, including the Waco and Northwestern Division amount to a total mileage of 521 $\frac{1}{4}$ miles. (Bill of Complaint, R. p. 9). In other words, the Waco and Northwestern Division constitutes 11 13-100 per cent. of the whole system.

12th. The indebtedness due by the Houston and Texas Central Railway Company to the Lackawanna Company was liquidated by judgment of the District Court of Dallas County, in suit instituted by the Lackawanna Company against the defendant Railway Company, at the sum of \$555,914.25, with interest at eight per cent. per annum from May 17th, 1889 (R. p. 676), and upon this judgment execution issued August 19th, 1889, which was returned by the Sheriff of Dallas County not executed, there being no property found in Dallas County, subject to execution. (R. p. 670).

Upon these facts, the intervention of the Lackawanna

Iron and Coal Company came to trial before the Honorable the United States Circuit Court for the Eastern District of Texas, which Court dismissed the same.

The cause is brought into this Court by an appeal under which error has been assigned as follows :

First. The said decree is erroneous in denying the relief herein prayed for by intervenors and in dismissing the intervention herein.

Second. That the claim of intervenors is one made for materials and supplies necessary to keep the railways forming the subject matter of the foreclosure herein a going concern from day to day. That a continuance of the running of said railway involved the interests of the public, the traffic of the road and the continuance of the franchises of the defendant Railway Company herein, and that said supplies, added to the value of the property mortgaged to complainant herein, and the debt incurred for the same was and is entitled to preference both upon the revenues of the railways forming the subject matter of this cause, and upon the *corpus* of the same, over the claims of complainant herein, and that this Honorable Court erred in not so holding, and in not decreeing in favor of intervenors as in their intervention prayed for.

Third. That the income of the railways forming the subject matter of the bill of foreclosure in this cause, both prior to the filing of complainant's bill of foreclosure herein and subsequent thereto, and both prior to and subsequent to the taking possession of said railways by this Honorable Court, was used for the payment of interest upon complainant's mortgage and for permanent improvements upon said railways, and was diverted for the benefit of complainant herein

and of the holders of bonds described in the mortgage forming the subject matter of the bill of foreclosure herein, and at the expense of the current debt fund, and that intervenors are entitled to a restoration to the extent of such diversion of said current debt fund, and that this Honorable Court erred in not decreeing such restoration, and in not decreeing in favor of intervenors upon the current debt fund when thus restored.

Fourth. That the debt of intervenors is entitled to a lien upon the revenues of the defendant Railway Company in the possession of this Honorable Court, both under the laws of the State of Texas and under general principles of equity jurisprudence, and that both under said laws and under said jurisprudence intervenors are entitled to a payment of their claim out of said revenues, with priority over the claim of complainant herein, and that this Honorable Court erred in not so holding and ordering. (R. pp. 683, 684).

Instead of following the assignment of errors closely, we think that we can present the case more satisfactorily to the Court by discussing it in the manner in which we shall, and if that discussion proves satisfactory to your Honors, it will necessitate the sustaining of these assignments of error, and the rendering of a decree in favor of the Lackawanna Iron and Coal Company, intervenor.

We maintain, and shall press upon your Honors the following propositions, to-wit.:

I.

That the claim of the Lackawanna Company is one of the character repeatedly recognized by the Supreme Court of the United States as a charge in equity on the continuing

income of a railway company as well that which comes into the hands of the Court after the receiver is appointed as that before, and that so far as this current expense creditor is concerned, the Court should use the income of the receivership in the way in which the company would have been bound in equity and good conscience to use it, if no change in the possession had taken place; and further, that if the income has been diverted from the payment of current income creditors to the payment of mortgage creditors, or to the improvement of the mortgaged property, the current income fund, to the extent to which it has been depleted, will be restored out of the proceeds of sale of the mortgaged property.

II.

That the Farmers' Loan and Trust Company and the beneficiaries under its trust have never had a lien upon any of the earnings of the Waco and Northwestern Division of the Houston and Texas Central Railway Company, and they have no lien upon any such income now in the hands of the Court.

III.

If neither party has, nor at any time during this litigation has had, a lien on the income of the railways mortgaged in this case, then the Court will proceed upon the principle that equality is equity, and will distribute the income ratably among all the creditors of the defendant Railway Company before the Court.

I and II.

The authorities upon the first two propositions are, in many instances, the same cases, and we therefore consider them together, and we say that a long line of authorities,

beginning with the case of *Fosdick vs. Schall*, 99 U. S. 235, and running down to the present day, maintain the propositions :

1st. That a mortgagee, even where the income is mortgaged, has no lien upon the earnings of a railway company while the property remains in the hands of the company, nor until the mortgagee takes some steps authorized by the mortgage or by the course of equity procedure to appropriate the earnings.

2d. That even where income is mortgaged, the income out of which the mortgagee is entitled to be paid while out of possession, is the net income obtained by deducting from the gross earnings what is required for necessary operating and managing expenses, proper equipments and useful improvements. From this it follows, that persons to whom debts are due at the time a mortgaged road goes into the hands of a receiver, for necessary operating and managing expenses, proper equipments, and useful improvements, are entitled to a priority over mortgage creditors as to any fund derived from income which may be received by the receiver from the company.

3d. That an unpaid creditor, for necessary operating and managing expenses, proper equipments and useful improvements, is entitled to priority over mortgage creditors as to any fund derived from income whilst the property is in the hands of a receiver of the Court.

4th. That where current earnings have been used by the officers of a company, or by the Court, for the benefit of mortgage creditors, in paying bonded interest, purchasing additional equipments, or making permanent improvements on the fixed property, the mortgage security is

chargeable in equity with the restoration of the fund thus improperly diverted.

5th. If the current earnings claimant has been guilty of laches, no preference will be allowed to him over the mortgage creditor. It is difficult, if not impossible, to lay down any fixed rule or rules as to when claims should be considered stale. Each case must be governed by the particular facts which appear therein. The limit of six months, sometimes referred to, is not supported by the slightest authority, in so far as the decisions of the Supreme Court are concerned.

We now turn to the authorities :

In the 99 *U. S.* are found the four cases of *Fosdick vs. Schall*, p. 235; *Fosdick vs. Car Company*, p. 256; *Huidekoper vs. Locomotive Works*, p. 258, and *Hale vs. Frost*, p. 389.

The first of these is the leading case upon the relative rights of secured and unsecured creditors of railroads which have been placed in the hands of receivers. The other three cases are mere applications of the doctrine laid down in the first case, which was exhaustively argued, and wherein the Supreme Court of the United States arrived at a conclusion which has ever since been the law of the Federal Courts.

The decision is one which it is very difficult to condense, for the reason that it is a leading case upon a most important subject, and the quotations which we shall now make from it are unsatisfactory, at best. The exact question which drew from the Court the expressions which we shall quote, was this: "Was the order for the payment out of the fund in Court of the rent of certain cars during the time that they were used by the receivers appointed by the

State Court, and for six months before, justifiable under the circumstances of the case?"

The receivership in the case before the Supreme Court had been instituted in a State Court, but the cause was subsequently removed to the United States Circuit Court, so that, for all practical purposes, the case was the same as if it had been originally instituted in the Circuit Court.

Answering the above question, the Court said (99 U. S. pp. 251 *et seq.*):

"As to the second question, we have no doubt that when a court of chancery is asked by railroad mortgagees to appoint a receiver of railroad property, pending proceedings for foreclosure, the court, in the exercise of a sound judicial discretion, may, as a condition of issuing the necessary order, impose such terms in reference to the payment from the income during the receivership of outstanding debts for labor, supplies, equipment, or permanent improvement of the mortgaged property as may, under the circumstances of the particular case, appear to be reasonable. Railroad mortgages and the rights of railroad mortgagees are comparatively new in the history of judicial proceedings. They are peculiar in their character and affect peculiar interests. The amounts involved are generally large, and the rights of the parties oftentimes complicated and conflicting. It rarely happens that a foreclosure is carried through to the end without some concessions by some parties from their strict legal rights, in order to secure advantages that could not otherwise be attained, and which it is supposed will operate for the general good of all who are interested. This results almost as a matter of necessity from the peculiar circumstances which surround such litigation.

"The business of all railroad companies is done to a greater or less extent on credit. This credit is longer or shorter, as the necessities of the case require; and when companies become pecuniarily embarrassed, it frequently

happens that debts for labor, supplies, equipment and improvements are permitted to accumulate, in order that bonded interest may be paid and a disastrous foreclosure postponed, if not altogether avoided. In this way the daily and monthly earnings which ordinarily should go to pay the daily and monthly expenses are kept from those to whom in equity they belong, and used to pay the mortgage debt. The income out of which the mortgagee is to be paid is the net income obtained by deducting from the gross earnings what is required for necessary operating and managing expenses, proper equipment, and useful improvements. Every railroad mortgagee in accepting his security impliedly agrees that the current debts made in the ordinary course of business shall be paid from the current receipts before he has any claim upon the income. If for the convenience of the moment something is taken from what may not improperly be called the current debt fund, and put into that which belongs to the mortgage creditors, it certainly is not inequitable for the court, when asked by the mortgagees, to take possession of the future income and hold it for their benefit, to require as a condition of such an order that what is due from the earnings to the current debt shall be paid by the court from the future current receipts before anything derived from that source goes to the mortgagees. In this way the court will only do what if a receiver should not be appointed the company ought itself to do. For even though the mortgage may in terms give a lien upon the profits and income, until possession of the mortgaged premises is actually taken or something equivalent done, the whole earnings belong to the company and are subject to its control. *Galveston Railroad vs. Cowdrey*, 11 Wall. 459; *Gilman et al. vs. Illinois and Mississippi Telegraph Co.*, 91 U. S. 603; *American Bridge Co. vs. Heidelberg*, 94 Id. 798.

"The mortgagee has his strict rights which he may enforce in the ordinary way. If he asks no favors, he need grant none. But if he calls upon a court of chancery to put forth its extraordinary powers and grant him purely equitable relief, he may with propriety be required to

submit to the operation of a rule which always applies in such cases, and do equity in order to get equity. The appointment of a receiver is not a matter of strict right. Such an application always calls for the exercise of judicial discretion; and the Chancellor should so mould his order that, while favoring one, injustice is not done to another. If this cannot be accomplished, the application should ordinarily be denied.

"We think, also, that if no such order is made when the receiver is appointed, and it appears in the progress of the cause that bonded interest has been paid, additional equipment provided, or lasting and valuable improvements made out of earnings which ought in equity to have been employed to keep down debts for labor, supplies and the like, it is within the power of the court to use the income of the receivership to discharge obligations which, but for the diversion of funds, would have been paid in the ordinary course of business. This, not because the creditors to whom such debts are due have in law a lien upon the mortgaged property or the income, but because, in a sense, the officers of the company are trustees of the earnings for the benefit of the different classes of creditors and the stockholders; and if they give to one class of creditors that which properly belongs to another, the court may, upon an adjustment of the accounts, so use the income which comes into its own hands, as if practicable, to restore the parties to their original equitable rights. While, ordinarily, this power is confined to the appropriation of the income of the receivership and the proceeds of moneyed assets that have been taken from the company, cases may arise where equity will require the use of the proceeds of the sale of the mortgaged property in the same way. Thus it often happens that, in the course of the administration of the cause, the court is called upon to take income, which would otherwise be applied to the payment of old debts, for current expenses, and use it to make permanent improvements on the fixed property, or to buy additional equipment. In this way the value of the mortgaged property is not unfrequently materially increased.

It is not to be supposed that any such use of the income will be directed by the court, without giving the parties in interest an opportunity to be heard against it. Generally, as we know, both from observation and experience, all such orders are made at the request of the parties or with their consent. Under such circumstances, it is easy to see that there may sometimes be a propriety in paying back to the income from the proceeds of the sale what is thus again diverted from the current debt fund in order to increase the value of the property sold. The same may sometimes be true in respect to expenditures before the receivership. No fixed and inflexible rule can be laid down for the government of the courts in all cases. Each case will necessarily have its own peculiarities, which must to a greater or less extent influence the Chancellor when he comes to act. The power rests upon the fact, that in the administration of the affairs of the company the mortgage creditors have got possession of that which in equity belonged to the whole or a part of the general creditors. Whatever is done, therefore, must be with a view to a restoration by the mortgage creditors of that which they have thus inequitably obtained. It follows that if there has been in reality no diversion, there can be no restoration; and that the amount of restoration should be made to depend upon the amount of the diversion. If in the exercise of this power errors are committed, they, like others, are open to correction on appeal. All depends upon a proper application of well settled rules of equity jurisprudence to the facts of the case, as established by the evidence."

The other most important case to which we shall direct the attention of the Court is the case of *Burnham vs. Bowen*, 111 U. S. 777 et seq.:

"When a court of chancery, in enforcing the rights of mortgage creditors, takes possession of a mortgaged railroad and thus deprives the company of the power of receiving any further earnings, it ought to do what the company would have been bound to do if it had remained in

possession, that is to say, pay out of what it receives from earnings all the debts which in equity and good conscience, considering the character of the business, are chargeable upon such earnings. In other words, what may properly be termed the debts of the income should be paid from the income, before it is applied in any way to the use of the mortgagees. The business of a railroad should be treated by a court of equity under such circumstances as a 'going concern,' not to be embarrassed by any unnecessary interference with the relations of those who are engaged in or affected by it."

* * * * *

"Under these circumstances, we think the debt was a charge in equity, on the continuing income, as well that which came into the hands of the court after the receiver was appointed as that before. When, therefore, the court took the earnings of the receivership and applied them to the payment of the fixed charges on the railroad structures, thus increasing the security of the bondholders at the expense of the labor and supply creditors, there was such a diversion of what is denominated in *Fosdick vs. Schall* the 'current debt fund,' as to make it proper to require the mortgagees to pay it back. So far as current expense creditors are concerned, the court should use the income of the receivership in the way the company would have been bound in equity and good conscience to use it if no change in the possession had been made. This rule is in strict accordance with the decision in *Fosdick vs. Schall*, which we see no reason to modify in any particular."

* * * * *

"We do not now hold, any more than we did in *Fosdick vs. Schall*, or *Huidekoper vs. Locomotive Works*, 99 U. S. 258-260, that the income of a railroad in the hands of a receiver, for the benefit of mortgage creditors who have a lien upon it under their mortgage, can be taken away from them and used to pay the general creditors of the road. All we then decided, and we now decide, is, that if current earnings are used for the benefit of mortgage creditors before current expenses are paid, the mortgage security

is chargeable in equity with the restoration of the fund which has been thus improperly applied to their use. The decree of the Circuit Court is affirmed."

There does not seem to be much contest as to these general principles, but there is a vague claim that the intervenor has been guilty of some ill-defined laches, and an attempt is made to insist upon the "six months" rule, which has been recognized in some cases by inferior Federal Courts.

The Supreme Court is sometimes said to have laid down the six months rule in the case of *Fosdick vs. Schall*, but this is clearly a mistake.

The decree in the lower court was in favor of Schall, allowing him the rental of the cars for six months before the appointment of the receiver. This portion of the decree was reversed in the Supreme Court, because it was held that Schall had no contract of lease, and was, therefore, entitled to no rental, and no question ever arose requiring the Supreme Court to fix a limit prior to the receivership, beyond which it would not go in paying current earning creditors.

In *Hale vs. Frost*, however, in the same volume, the facts were that the receiver was appointed *May 19th, 1875*, and that Hale, Ayer & Company recovered upon a claim which extended back to a date long prior to *August, 1873*, and for an account which had been repeatedly evidenced by notes, upon which payments had been made, and new notes given. (*See 99 U. S. 391*).

In the case of *Burnham vs. Bowen*, the claim allowed was for coal furnished during the year 1874, but the precise time was not given. The receiver was appointed in Janu-

ary, 1875, and the claim was allowed, Chief Justice Waite saying:

"In the agreed facts upon which the case was heard below, it is stated that the coal was furnished during the year 1874, but the precise time in the year is not given. From what does appear, however, we are satisfied that at the time of the appointment of the receiver this was one of the current debts for operating expenses, made in the ordinary course of continuing business, to be paid out of current earnings, and that the payment would have been made at the time agreed on if the company had remained in possession. The renewed acceptances given after the receiver was appointed, indicate that the originals were for different amounts, maturing a month apart, thus implying monthly settlements of monthly accounts of a somewhat extended credit to meet the business requirements of what may have been, and probably was, at the time, an embarrassed railroad company."

Read the Master's Report; look at the list of notes contained at page 676, and you will see a duplicate of the case of *Burnham vs. Bowen*.

We do not think it necessary to give extended citations from any other authorities at the present time, but would merely refer to the case of *Union Trust Company vs. Illinois Midland Railway Co.*, 117 U. S. 434, which fully affirmed everything held in the foregoing cases, and which is also of importance upon other matters to which we shall hereafter have occasion to refer.

We would also refer to the case of *Union Trust Company vs. Morrison*, 125 U. S. 613, in which case the Supreme Court held, in reference to cases of this class, that each case was one *sui generis*; and in reference to the special case at bar, said:

"The case is a special one ; and in view of the discretion which the Court of first instance is obliged to exercise in matters of this character, taking all the circumstances into consideration, we cannot say that equitable relief was unduly extended in allowing the intervenor's claim."

The only rule, so far as we have been able to find, which has been sanctioned by the Supreme Court of the United States, is, that each case is to be decided upon its own merits, and that all claims of the nature allowed as liens enjoying priority over mortgages, must have been incurred within a reasonable time prior to the receivership. What is a reasonable time is a question of law, depending upon all the circumstances of the particular case. See *Paine vs. Central Vermont Railroad Company*, and cases cited, 118 U. S. 160.

That a first mortgagee who is made a party to a suit filed by a junior encumbrancer, wherein a receiver is appointed, who stands by and allows the income of the mortgaged property to be used in making betterments upon the property, is estopped from afterwards objecting to a decree restoring to the current debt fund income, thus diverted and used for improving the security of the mortgage creditor, is distinctly held in *Milttenberger vs. Logansport R. R. Co.*, 106 U. S. 286; *Union Trust Company vs. Illinois Midland Ry. Co.*, 117 U. S. 434, and *Souther vs. Railroad Co.*, 107 U. S. 591.

In the latter case, Chief Justice Waite said :

"The income of the receivership, instead of being applied in accordance with the order to pay the debts for supplies and labor, was used, with the consent, and it may fairly well be inferred, at the request of the bondholders, to buy additional grounds, rolling stock, etc., and to make permanent improvements, thus adding to the value of the

property which was afterwards sold. There is nothing whatever to indicate that in thus using the income, it was the intention of the Court to revoke the original order. It seems to have been found, in the administration of the cause, that by using the income to add to the value of the fixed property, the interests of all parties would be promoted, and so the fund which in equity belonged to the labor and supply creditors, was for the time being diverted from them and put into improvements and additions, the proceeds of which are now in Court. It is not to be presumed that this diversion would have been authorized if the value of the property added to and improved was not to be correspondingly increased.

"Clearly, therefore, on the face of the transaction, the fund in Court represents in equity the income which belongs to the labor and supply creditors, as well as the mortgage security, and there was no impropriety in appropriating it, as far as necessary to pay the creditors specially provided for when the receiver was appointed."

The case of the *Union Trust Co. vs. Illinois Midland Ry. Co.*, 117 U. S. 434, is also authority for the proposition that it is proper to apportion among the several sections of a railway in proportion to their length, the items allowed priority of lien. The Court rests its conclusion upon a number of considerations, and the whole argument upon the subject, and the decision of the Court upon this particular branch of the case, will be found at pages 465 to 469, inclusive, of the volume referred to.

The most important portion of the decision, and the one particularly applying to this case, is stated as follows by Judge Blatchford, on page 468 :

"Independently of this, it is entirely sufficient to rest our conclusion on the principle that non-action on the part of the Paris and Decatur bondholders and their trustee, which allowed the court and the receivers to go on during the en-

tire litigation, contracting debts in respect to the whole line operated as a unit, and administering the property as one, under circumstances where, as shown, it was and is impossible to separate the interests as to expenditures and benefits, in respect to the matters now questioned, and where important rights have accrued on the faith of the unity of the interests, amounts to such acquiescence as should operate as an estoppel. The interlocutory decree contains a clause in accordance with the foregoing conclusion, and, for the reasons above stated, we think it is right."

From an application of the principles of the above decisions to the facts of this case, we respectfully submit that the following conclusions are sound, to-wit:

1st. The Lackawanna Iron and Coal Company is a current earnings creditor, within the meaning of the doctrine in *Fosdick vs. Schall*, and the other cases following that case.

2d. The Lackawanna Company by reason of the saving clauses contained in every decree and order rendered by the United States Circuit Court for the Eastern District of Texas, affecting the income of the railways in its possession, up to and including the foreclosure decree in No. 227, stands to-day in the same position that it did on the day on which it filed its original intervention in suit No. 185.

3d. The Farmers' Loan and Trust Company and the beneficiaries under its trust, under the clauses in these same decrees and orders, taken or accepted by them without protest, are now estopped from denying that the Lackawanna Company stands exactly where it stood when it filed its intervention in Cause No. 185. The Lackawanna Company is entitled to a decree recognizing its lien for the sum of \$6,426.51 and \$99,300.64, being the proportionate price of rails laid upon the Waco and Northwestern

Division, and these amounts bear interest at 6 per cent. per annum from May 21, 1885, until paid, this being the due date of the last of the notes given to the Lackawanna Company, and being adopted as the date most favorable to the Farmers' Loan and Trust Company, and in order to avoid an intricate calculation apportioning the amount due in respect to the Waco and Northwestern Division to each of the many notes given to the Lackawanna Company.

4th. The decree in favor of the Lackawanna Company is justified upon every principle laid down by the Supreme Court as to the rights of a current income creditor as against a mortgagee of the income; and *a fortiori* against a mortgagee who, like the Farmers' Loan and Trust Company, in this case, has no mortgage of the income.

5th. It is shown that the Receivers in Cause No. 185 collected from the operations of the railways of the defendant Railway Company, during their administration, \$423,000 over and above all their expenditures of every kind whatsoever; also, that they collected from assets of the defendant Railroad Company, consisting of traffic balances, sales of old rails and old cars, a sum total of \$401,811.12. It is shown further, that the said Receivers expended a sum total of \$1,512,842.18 out of the revenues of the Receivership for the benefit of mortgage creditors. As the mileage of the Waco and Northwestern Division constituted 11.13 per cent. of the mileage of the whole Houston and Texas Central system, it follows that the *pro rata* of such expenditures to be charged to the Waco and Northwestern Division amounts to \$168,379.33, whereof \$91,300 was paid to the mortgage creditors for coupons upon their bonds, and the remainder expended in betterments, fully described in

the Master's findings. The diversion was therefore ample to cover our claim in full, with interest.

Against all the decisions which we have cited, the counsel for the intervenors, Moran Bros. and others, cites the case of *Bound vs. South Carolina Railway Company*, a decision rendered by Judge Fuller and Judges Hughes and Morris in the Circuit Court of Appeals for the Fourth Circuit, reported in *58 Fed. Rep. 473*, reversing the well considered opinion of Judge Simonton, which will be found in *47 Fed. Rep. p. 30*.

Whether or not the extreme necessity for the rails was shown in the Bound case that has been shown in this case, does not appear from the report, but, however that may be, we respectfully submit that the decision in question is at variance with the whole line of decisions which we have cited, and should be disregarded. We ask this Court to follow the long line of decisions of the Supreme Court, rather than a single contradictory decision of another Court of concurrent jurisdiction with yourselves.

Inasmuch as the allowance of a claim of the character of the one set up by the Lackawanna Company is one resting so largely in the discretion of the Chancellor, it is important to show the nature of any conflicting claims upon the revenues of the defendant Railway Company, because if no conflicting claims exist, or if the conflicting claims be of a character not commending themselves to the Chancellor, they may be disregarded in the exercise of the judicial discretion allowed in such cases. That the mortgagees, under this mortgage, had no mortgage upon income, is seen from a mere inspection of their mortgage. Even if they had had a mortgage upon income,

such mortgage would have given them no lien upon the earnings of the road while it remained in the hands of the Company.

Railroad Co. vs. Cowdry, 11 Wall. 483.

Smith vs. Railroad, 124 Mass. 157.

Gilman vs. Telegraph Company, 91 U. S. 616.

Bridge Co. vs. Heidelberg, 94 U. S. 798.

The lien of a mortgage upon the earnings of a railroad depends solely upon its terms, and until the trustee takes some steps authorized by the mortgage to appropriate the earnings, no lien attaches to them. *Miltenberger vs. Logansport Railway Co.*, 106 U. S. 307.

Another most instructive case upon this branch of the subject is *Kountze vs. Omaha Hotel Company*, 107 U. S. 378, *et seq.*

This case was an action on an appeal bond given for *supersedeas* of execution on a decree of foreclosure rendered by the Circuit Court for the District of Nebraska, and the question was as to the measure of damages to be recovered on the bond. In determining this question it was necessary to determine whether or not the plaintiffs were entitled to recover rents and profits or damages for the use and detention, as it is otherwise called.

Upon this branch of the case Judge Bradley, in 107 U. S. 392 *et seq.*, said :

"And yet there is a material difference between the case of ejectment and a suit for the foreclosure of a mortgage.

"The difference is this : In ejectment the property of the land is in question, and if the plaintiff has the right, he is entitled to immediate possession, and to the perception of the rents and profits, which belong to him, and for which the defendant in possession is accountable to him.

Every dollar, or dollar's worth, is so much of the plaintiff's property of which he is deprived. And the same is true in dower. But, in the case of a mortgage, the land is in the nature of a pledge; and it is only the land itself—the specific thing—which is pledged. The rents and profits are not pledged; they belong to the tenant in possession, whether the mortgagor or a third person claiming under him. This is not only the common law, but it is the express statute law of Nebraska, which declares that, 'in the absence of stipulations to the contrary, the mortgagor retains the legal title and right of possession.' The plaintiff in this case was not entitled to possession, nor to the rents and profits. His foreclosure suit did not seek possession, but sought a sale of the specific thing—the land. In such a case, until the litigation is ended, it doth not appear that there must be a sale, or even that the plaintiff is entitled to a sale. The defendant in possession is entitled to redeem the land until a sale is made, and until then he is entitled to the rents and profits which belong to him as of right. The taking of the rents and profits prior to the sale does not injure the mortgagee, for the simple reason that they do not belong to him. Waste, that is, destruction or injury to the land itself, as before stated, is an injury to the mortgagee. It diminishes the value of the pledge; and for such injury no doubt he might recover on an appeal bond. Other deteriorations, such as occur by want of repairs, accumulation of taxes, fires not covered by reasonable insurance, and the like, probably might also be fairly covered by the bond. But perception of rents and profits is the mortgagor's right until a final determination of the right to sell, and a sale made accordingly."

See also *Teal vs. Walker*, 111 U. S. 242, where the Court, after announcing the general doctrine, further holds, that the case against the right of the mortgagee to recover rents and profits before foreclosure, is strengthened by the provisions of the General Statutes of the State of Oregon, to the effect that a mortgage of real property shall not be

deemed a conveyance so as to enable the owner of the mortgage to recover possession of the real property without a foreclosure and sale according to law.

The laws of Texas are exactly the same upon this subject as those of the State of Oregon.

Article 1340 of the Revised Statutes of Texas (see 1 Sayles Texas Civil Statutes, p. 447) provides that :

"Judgments for the foreclosure of mortgages and other liens shall be, that the plaintiff recover his debt, damages and costs, with a foreclosure of the plaintiff's lien on the property subject thereto, and that an order of sale shall issue to the sheriff or any constable of the county where such property may be, directing him to seize and sell the same as under execution, in satisfaction of the judgment, etc."

The Supreme Court of Texas, by a long line of decisions, the most noteworthy of which is the case of *Duty vs. Graham*, 12 Texas, 427, has expressly decided that, under this statute, and under the laws of the State of Texas, a mortgage is a mere security for the payment of a debt. The mortgagor remains the real owner of the land and entitled to its possession, and the mortgagee cannot sustain an action of trespass to try title or ejectment against the mortgagor on the mortgage.

By the terms of the mortgage sued upon in this cause, the Houston and Texas Central Railway Company was to remain in possession of its property, and had the right to operate the same and appropriate earnings and income until default, continuing for the time stipulated in the mortgage, in which event the trustee was empowered to take possession of the railroad and operate it, applying net earnings to the satisfaction of interest. The trustee not

only failed to take possession of the road, but never, until it filed its foreclosure bill in Cause No. 227, took any steps whatsoever to assert any lien upon the earnings.

The provision of the mortgage, that the trustee should take possession, is, however, absolutely worthless, under the laws of the State of Texas.

We, therefore, respectfully submit that the Farmers' Loan and Trust Company has never had the slightest title to the rents and revenues of the property of the defendant corporation, either before or since the filing of its bill of foreclosure in this cause, and we, therefore, conclude that the Lackawanna Company and others similarly situated are the only persons before the Court having any claim to the income in question.

We do not particularly refer to the claims of the defendant, Downs, for the reason that he bought under the terms of a final decree, expressly reserving the rights of the Lackawanna Company, which rights are, as we have before stated, reserved by every decree and decretal order in this cause and in Causes Nos. 198 and 185, up to and including the final decree in Cause No. 227. Under the decree, under which he bought, and under the reservations in the same, Downs stands absolutely in the shoes of the Houston and Texas Central Railway Company, defendant, and we are entitled to have our rights adjudicated exactly as if Downs were not in the case.

III.

If the Court should conclude that neither the Farmers' Loan and Trust Company nor the Lackawanna Company has any lien on income, then the income in the hands of the Receiver must, necessarily, be pro-rated between the

different creditors of the defendant Company before the Court. In such an event, equality is equity.

We respectfully submit that all the assignments of error are well taken, and that the Lackawanna Company is entitled to a reversal of the judgment of the lower court, and to a decree in its favor ordering the payment, out of the funds in the custody of the Court, to said Lackawanna Company of the two sums of \$6,246.51 and \$99,300.64, with interest at six per cent. per annum from May, 1885, until paid; or, if the Court should conclude that neither the Lackawanna Company nor the Farmers' Loan and Trust Company has established any lien in the premises, then the cause should be remanded to the lower court with instructions to divide the income in the hands of said Court, after payment of all costs and expenses, between the different creditors of the defendant corporation before the Court pro rata.

Respectfully submitted,

E. B. KRUTTSCHNITT,

E. H. FARRAR,

B. F. JONAS,

H. T. GURLEY,

*Solicitors and of Counsel for Lackawanna
Coal and Iron Co.*

N. O., DEC. 30, 1896.

N^o. 22.

Brief of Kruttschnitt & Co.

Petitioners.
Supreme Court of the United States.

OCTOBER TERM, 1898.

Filed Feb. 23, 1899.

No. 122.

THE LACKAWANNA IRON AND COAL COMPANY ET AL.,
Intervenors and Petitioners,
against

THE FARMERS' LOAN AND TRUST COMPANY ET AL.,
Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT
OF APPEALS FOR THE FIFTH CIRCUIT.

Brief on Behalf of the Petitioners.

E. B. KRUTTSCHNITT,
MAXWELL EVARTS,
Of Counsel for Petitioners.

Supreme Court of the United States.

OCTOBER TERM, 1898.

No. 162.

THE LACKAWANNA IRON AND COAL CO.

ET AL.,

Intervenors and Petitioners,

AGAINST

THE FARMERS' LOAN AND TRUST CO.

ET AL.

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES
CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT.

BRIEF ON BEHALF OF THE PETITIONERS.

Statement.

The Houston and Texas Central Railway Company, a corporation of the State of Texas, owned at the time of its failure about 520 miles of railway in that State, consisting of a Main Line from Houston to Denison, a branch line from Hempstead to Austin, called the Western Division, and a branch line from Bremond to Ross, called the Waco and Northwestern Division (Rec., p. 3). This Waco and Northwestern Division was 58 miles in length, and is the division in respect of the income of which the petitioners claim an equitable lien for the value of steel rails laid on the line shortly before the failure of the Company, claiming also that such equitable lien is superior to the claims of the bondholders in respect of such income.

The property of the Company was subject to the liens, of seven mortgages, known, respectively, as the Main Line First Mortgage, Western Division First Mortgage, *Waco and Northwestern Division First Mortgage*, Main Line and Western Division Consolidated Mortgage, Waco and Northwestern Division Consolidated Mortgage, Income and Indemnity Mortgage and General Mortgage (Rec., p. 3). The present intervention was filed in a suit brought by the Farmers' Loan and Trust Company, as Trustee, to foreclose the Waco and Northwestern Division First Mortgage.

On January 1, 1885, the Company made default in the payment of interest on its First Mortgage bonds (Rec., p. 105), and in February, 1885, Receivers of the properties of the Company were appointed by the United States Circuit Court for the Eastern District of Texas as hereinafter stated.

Between February and May, 1884, there were delivered by the petitioner new steel rails which were subsequently laid upon this Waco and Northwestern Division, which replaced 30.8 miles out of the 58 miles constituting that Division.

The building of the Houston and Texas Central Railway was begun in 1857, and completed in 1875 (Rec., p. 104), and prior to 1883 (with the exception of about 5,000 tons, *i. e.*, about 55 or 60 miles out of 520 miles, the length of the entire road), no new rails had been laid in any of its tracks since the road was first built. The condition of the road at the time when the new steel rails purchased under contracts with the petitioner as hereinafter stated were laid in the track is shown by the petition at page 78 of the record, as follows :

" That all of said steel rails so delivered were used for the useful improvement and necessary repair of the Main Line of said Houston and Texas Central Railway Co. and of the Western division thereof, and of the Waco and Northwestern divis-

ion thereof, to the extent hereinafter more fully set forth. That said steel rails were so absolutely necessary to said company to enable it to replace the old iron with which its tracks were laid that it is doubtful whether said company could have maintained its existence as a common carrier without them. That prior to the improvement and repair of said line of road with steel rails, as aforesaid, accidents to life and limb and damage to property was so great, owing to the condition of the tracks of said company, that the name of the Houston and Texas Central Railway Company became a terror to the traveling and shipping public, and a byword and a reproach. That by means of said steel rails so furnished by petitioner to said defendant railway, the railway of said defendant company has been kept in safe running order, its business and importance increased, and said railway thereby rendered more valuable to the bondholders under the various mortgages thereupon, and especially to the bondholders under the deed of trust and mortgage held by complainant herein, and upon which its bill of foreclosure has been filed in this cause. That said indebtedness was contracted by defendant in consideration of its promise to pay the same out of the earnings of its railway. That your petitioner made the contracts aforesaid and furnished the steel rail aforesaid under the expectation and belief that it would be paid for the same out of the revenues and earnings of said property; and that in case said revenues should not be sufficient, out of the proceeds of the sale thereof, by preference over any of the holders of mortgage bonds secured by deeds of trust on said property, but that said defendant, instead of paying the debt so justly due to your petitioner, out of the earnings of said railway, has entirely failed to pay the same or any part thereof,

as hereinabove set forth ; and that the truth is, and your petitioner so charges, that the said defendant has used a large amount of said earnings for the payment of coupons upon bonds secured by the mortgage, upon which a bill of foreclosure has herein been filed, although the holders of said coupons were only entitled to receive payment thereof after the defendant had paid your petitioner the amounts advanced and expended in the manner and for the purposes hereinabove set forth. That said steel rails so purchased by said railway company were actually used for the betterment and improvement of its railway aforesaid, and not for purposes of construction ; and that the said rails have been an increment to the value of the property mortgaged to said bondholders, and that your petitioner has the right to claim, and does claim, that the revenues of said railway property should be applied to the payment of petitioner's said indebtedness, by preference over the claim of any bondholders or coupon holders whomsoever."

The Special Master, appointed by the Court to report upon the intervention in this cause of the Lackawanna Company, found

" that, at the time when the contracts hereinbefore mentioned were entered into between said Lackawanna Company and the defendant Railway Company, *that the condition of the track of the defendant railway company was such that the demand for new rails upon the most worn portion of the roadway was practically imperative. * * * The condition of these roads was bad, except such portions as had been relaid with 5,000 tons of rails purchased prior to December 28, 1882. There was continual breakage of rails and wrecking of trains ; the track was unsafe, and was generally so regarded, not only by 'railroad men,' but by the*

traveling public; the damage to merchandise, rolling stock, etc., was continuous, and the need for new rails appears to have been 'absolutely necessary as a preservation of human life,' the loss of which was liable to occur at any moment" (Rec., p. 104).

The contracts between the Lackawanna Company, the intervenor and petitioner herein, and the Railway Company were made under date of December 28, 1882, April 26, 1883, and October 30, 1883, respectively, and provided for the furnishing by the intervenor of about 20,000 tons of steel rails to be laid in the track of the Railway Company.

CONTRACT OF DECEMBER 28TH, 1882.

All amounts due under this contract have been paid.

CONTRACT OF APRIL 26TH, 1883.

No claim is made to recover the small balance due for rails furnished to the Waco and Northwestern Division of the Railway Company under this contract as it is impossible to state positively how many of the rails delivered thereunder were actually used upon that Division.

CONTRACT OF OCTOBER 30TH, 1883.

Under this contract rails were delivered during the months of February, March, April and May, 1884, the purchase price of which was, under the terms of the contract, evidenced by Notes maturing six months from date of delivery, which Notes, by the terms of the contract itself, were subject to a right of renewal, which was exercised, so that the Notes became due in February, March, April and May, 1885 (Rec., p. 102). Of these rails an amount worth at the contract price \$99,300.64 was laid upon the Waco and

Northwestern Division. That is to say, 30⁸/₁₀ miles out of 58 miles (the length of the Waco and Northwestern Division) were laid with rails furnished under this third contract (Rec., p. 104). No security was stipulated or given by or under this contract, and the Special Master found :

“That when the aforesaid contracts were made with the said Lackawanna Company, both seller and buyer expected the debts to be paid from the net income of the Railway. That the credit extended under said contracts was at the request of and for the accommodation of the defendant railway company and upon its general credit. That said sales were made without any stipulation that security should be given by the defendant company for said rails or that payment therefor should be made out of any particular fund or in any particular way; that said sales were for an unusually large amount of rails, and the defendant was unable [to] pay cash therefor, and there was no other way of obtaining said rails except upon credit” (Rec., p. 104).

Prior to the date of maturity of any of the Notes issued under this third contract all the railways of the Houston and Texas Central Railway Company were placed in the hands of Receivers, and the Waco and Northwestern Division there remained at the time of the making of the decrees in the Circuit Court and Circuit Court of Appeals brought up by this *certiorari*. Pending determination of this *certiorari* proceeding there has been reserved in the registry of the Circuit Court an amount sufficient to pay the balance due for the steel rails involved in this proceeding.

The Receivership at first of all the properties of the Houston and Texas Central Railway Company, and thereafter of the Waco and Northwestern Division only, underwent certain changes and modifications from time to time in the various equity causes upon the

docket of the United States Circuit Court for the Eastern District of Texas, known as "Cause No. 185," "Consolidated Cause No. 198" and "Cause No. 227." The history of these three cases was as follows :

RECEIVERSHIP IN CAUSE NO. 185.

On February 16, 1885, the Southern Development Company, a corporation organized under the laws of the State of California, in its own behalf and in behalf of all other persons similarly situated, who might intervene in the suit to protect their own interests, filed its bill of complaint against the Houston and Texas Central Railway Company in the United States Circuit Court for the Eastern District of Texas, claiming a lien upon the net earnings of the railway company and all its properties superior in rank to the Mortgage Bonds. Under this bill Benjamin G. Clark and Charles Dillingham were appointed Receivers on the 21st day of February, 1885. Thereafter, and on or about the 18th day of April, 1885, the Southern Development Company filed an amended and supplemental bill, in which it made defendants Nelson S. Easton and James Rintoul and the Farmers' Loan and Trust Company, in their capacities as trustees of the various mortgages upon the property of the railway company.

The Lackawanna Company, on the 12th day of September, 1885, by permission of Court, filed a petition of intervention in this cause No. 185, praying that it might be allowed to intervene for its interests and join the complainant the Southern Development Company, and become itself a party complainant to said bill and amended and supplemental bill against all of the defendants therein, and it was further prayed in said intervening petition that the sum found due to said petitioner might be ordered to be paid out of the revenues of the defendant company, and might be declared a lien thereon and upon all the property of the railway

company superior in rank to the claims of the mortgage trustees and to the mortgage bonds and coupons issued under their various deeds of trust (Rec., pp. 105-108).

To the bill and amended and supplemental bill of the Southern Development Company there were filed by the defendant trustees general and special demurrers which were sustained by the Court, and the bill and amended and supplemental bill were dismissed on the 27th day of May, 1886, without prejudice to the rights of the complainants (the Southern Development Company and the Lackawanna Company) to assert their claims in such manner as they might be advised (Rec., p. 108).

The Farmers' Loan and Trust Company appeared in cause 185 only as defendant and filed its answer to both the original and supplemental bills of complaint therein. An inspection of this answer will show and the Master finds that its averments are all defensive, and it does not appear from said answer that the Farmers' Loan and Trust Company either demanded of the Court that the Receiver should hold the property for said trustee or that it in any other manner demanded any affirmative relief. Its appearance in said cause No. 185 was simply that of a defendant in opposition to the rights asserted in the original and supplemental bills of complaint (Record, pp. 115 and 116).

The Receivership under this bill continued until the 10th of July, 1886, and there was collected from the operation of the Houston and Texas Central Railway Company an amount of \$423,142.16 over and above operating expenses, taxes, etc. (Rec., p. 112).

The Receivers further collected from assets of the defendant railway company, consisting of traffic balances, sales of old rails and old cars, a sum total of \$265,921.42 (Record, p. 112).

The Receivers sold the rails removed from those portions of the Waco and Northwestern Division upon which the new steel rails furnished by the intervening petitioner were laid; 2,960 tons of such old rails were

removed from the 37 miles laid with new steel rails, and were sold at a price of \$13 per ton, net. *This would give a salvage of \$32,032 from the sale of old material removed from the 30.8 miles of road upon which new rails furnished by the Lackawanna Company under the contract of October 30th, 1883 (the Third Contract), were laid* (Record, p. 104).

RECEIVERSHIP IN CAUSE NO. 198.

Prior to the dismissal of the bill in cause No. 185 the defendants therein, Nelson S. Easton and James Rintoul, on the 21st of January, 1886, filed two bills in equity in the United States Circuit Court for the Eastern District of Texas in causes known as Nos. 198 and 199, for the foreclosure and sale of the railway property covered by the Main Line First Mortgage and the Western Division First Mortgage (Rec., pp. 108 and 109).

Thereafter, and on the 18th of April, 1886, the Farmers' Loan and Trust Company filed a bill in equity in the same Court in the cause known as No. 201, for the foreclosure of the general mortgage (Rec., pp. 108 and 109).

On the 26th day of May, 1886, the day before cause No. 185 was dismissed, an order was entered consolidating Nos. 198, 199 and 201 under the number 198, and upon the same day another order was entered appointing Nelson S. Easton, James Rintoul and Charles Dillingham receivers of all the property of the railway company and directing Clark and Dillingham as receivers in cause No. 185 to immediately transfer and deliver all the property held by them as such receivers to the receivers appointed in the consolidated cause No. 198 (Rec., p. 109).

On the 26th of November, 1886, the Lackawanna Company filed its petition of intervention in said Consolidated Cause No. 198 praying substantially for the same relief against all the railways, revenues, earnings and other properties of the railway company, including

the railways, revenues and earnings of the Waco and Northwestern Division thereof, as was prayed for by petition of intervention filed in said cause No. 185, and as is prayed for by its petition of intervention now before this court (Rec., p. 113).

A report was filed upon the petition of the Lackawanna Company in consolidated cause No. 198 by the special master appointed therein finding that under the facts of the case the debt for which said Company filed its petition "was of a character equitably entitling it to be discharged in preference to the debt embraced in the mortgages represented" in said consolidated cause (Rec., p. 113). To this report the Farmers' Loan & Trust Company, complainant in consolidated cause No. 198 filed exceptions, but said exceptions were never brought to a hearing and the same are still pending (Rec., p. 114).

A final decree of foreclosure was rendered in consolidated cause No. 198 on the 4th day of May, 1888, and the property was sold under this decree on the 8th of September, 1888, at Galveston, Texas, and the Waco and Northwestern Division was purchased by George E. Downs subject to the Waco and Northwestern First Mortgage, which is the mortgage involved in the present suit in which this petition of intervention was filed (Rec., p. 117).

In said final decree in consolidated cause No. 198 the court expressly reserved the right to charge the property ordered to be sold under said decree with any amounts that it might decree in favor of any intervention then on file, which of course included the intervention of the Lackawanna Company which was on file at the time of said decree (Rec., p. 117).

Afterwards and on the 20th day of April, 1889, the Lackawanna Company filed its petition in consolidated cause No. 198 asking that the receivership should continue and remain over the property then in the possession of the court until the claims and demands of the

Lackawanna Company upon said property should have been finally decreed upon, and if decreed in its favor should have been finally paid and settled. Upon this petition an order was entered directing the Receiver to retain possession of said property until the further order of the Court and further ordering that the receivership which had theretofore been ordered in cause No. 227 hereinafter referred to should be concurrent with the original receivership ordered in Consolidated Cause No. 198 and that the Receiver should keep separate accounts of the earnings and expenses of the Waco and Northwestern division of the railway company (Rec., p. 118).

In Consolidated Cause No. 198, the Farmers' Loan and Trust Company expressly assented to appear as complainant in cause 198, *but filed no bill of complaint therein as Trustee of the first Mortgage of the Waco and Northwestern Division*, and the bill of complaint filed by the Farmers' Loan and Trust Company in Cause No. 227 was not filed until long after the final decree in Consolidated Cause No. 198.

On March 21, 1887, the Farmers' Loan and Trust Company as Trustee under the Waco and Northwestern First Mortgage, filed an answer to the petition of Nelson S. Easton and James Rintoul in Consolidated Cause No. 198, praying the Court that any order which should be entered in Consolidated Cause No. 198 directing the payment by the Receivers out of the surplus of net earnings in their hands of any coupons falling due under any of the Trust Deeds executed by said Railway Company should provide for the payment by the Receivers out of the surplus of net earnings in their hands of the two coupons due under the Waco and Northwestern Division First Mortgage as well as under the other mortgages (Record, pp. 115-117).

Upon this application of the Farmers' Loan and Trust Company an order was entered on the 27th day of April, 1887, in said Consolidated Cause No. 198, directing that the coupons due January 1, 1885, and July 1, 1885, upon the First Mortgage Bonds of the Waco

and Northwestern Division should be paid with interest upon said coupons due January 1, 1885, from January 1, 1885, until May 1, 1887, at the rate of six per cent. per annum, and with interest upon one-half of the coupons due July 1, 1885, from said last-named date until May 1, 1887, when the same was ordered to be paid, and upon the remaining one-half of said coupon until it should have been paid. The two coupons, amounting altogether to \$91,371 (Rec., p. 121), were paid in pursuance of this order which expressly declared that it was

“ Without prejudice to the rights of defendant or of any intervenor in this cause or any final decree to be rendered in the same, nothing herein being decided as to the merits of the claim of the defendants or of intervenors and this order not in any manner stopping or affecting the rights of any party or intervenor in this cause ” (Rec., p. 117).

The Farmers' Loan and Trust Company, as Trustee of the First Mortgage of the Waco and Northwestern Division, also filed petitions in the United States Circuit Court for the Eastern District of Texas, on the 6th day of November, 1888, and on the 20th day of November, 1888, for payment of the remaining coupon interest due upon the Waco and Northwestern Division First Mortgage, but upon these petitions no order was ever entered (Rec., p. 117).

The Receivers in Consolidated Cause No. 198 during their administration realized out of proceeds of sale or collection of old assets of the defendant company the sum of \$135,889.70 (Record, p. 113).

The Receivers, in suits Nos. 185 and 198, during their administration, expended a sum total of \$1,536,116.38 outside of operating expenses, all of which, except the sum of \$23,274.20, clearly went into the pockets of the mortgage creditors, or was expended in betterments upon the properties mortgaged to them.

In other words, a total of \$1,512,842.18 of the revenues of the Receivership inured to the benefit of the mortgage creditors (Record, p. 112).

The accounts of the defendant Railway Company and of its Receivership, prior to April, 1889, were not kept in such a manner as to distinguish between earnings and expenses on the Waco and Northwestern Division, and those derived from the other divisions of defendant Company's railway (Record, p. 121).

RECEIVERSHIP IN CAUSE NO. 227.

On the 6th day of April, 1889, the Farmers' Loan and Trust Company, as complainant, filed its bill in equity against the Houston and Texas Central Railway Company and others seeking the foreclosure of the Waco and Northwestern Division First Mortgage (Rec., p. 2). *The filing of the bill on April 6th, 1889, was the first attempt by the Farmers' Loan and Trust Company, as trustee, to enforce its rights under this mortgage upon either corpus or income of the property mortgaged thereby.*

In this suit the Lackawanna Company on the 3d of November, 1891, filed the petition of intervention now before this Court (Rec., p. 75), the object of which was to obtain the recognition of an indebtedness due to it by the railway company, and represented by 25 promissory notes maturing during the first five months of 1885 and aggregating a total of \$445,175.50 face value. The amount of this indebtedness (including therein accrued interest) had previously been established by a judgment of the District Court at Dallas County, Texas, at the sum of \$555,914.25 with interest at eight per cent. per annum from May 17, 1889 (Rec., p. 86).

These Notes represented the purchase price of the steel rails bought by the Railway Company from the Lackawanna Company under the circumstances above set forth.

The petition (Record, pp. 86, *et seq.*), after reciting

the facts constituting the claim of the Lackawanna Company, asked that an account might be taken, under the direction of the Court, as to the amount due to the petitioner by the Railway Company and as to the dates and amounts of money paid by the defendant Railway Company to any of the mortgagees in the various trust deeds, described in the petition, showing*particularly the issue of bonds upon which such interest was paid ; and what proportion of the amounts so paid were paid out of current revenues of the Company, in the absence of earnings, and what amounts were so paid out of net earnings of the defendant Railway Company ; and particularly so as to show what amounts and proportions were so paid out of the net earnings of those portions of the railway of the defendant Railway Company, described in the Bill of Complaint of the Farmers' Loan and Trust Company, hereinabove referred to ; that an account might be taken showing the proportion of steel rails furnished by petitioner to the defendant Railway Company, used upon the railways described in the Bill of Complaint ; and that the account to be taken should also show all receipts and expenditures made by the Receivers, in whose hands the property had been placed under the various insolvency proceedings hereinbefore referred to, and which account should be taken in such manner as to show the dates when the expenditures were made, and the character of the expenditures, and in such manner as to show whether the expenditures were made for operating and running expenses, or for extraordinary repairs, betterments and improvements of the property or for the payment of fixed charges upon the same.

The petition further prayed that for the amounts due on such accounting to petitioner and equitably chargeable upon the railways described in the Bill of Complaint in said cause, there might be a decree against the defendant Railway Company, and against all of the parties complainant and defendant, decreeing

the sum so due to be liens upon the net earnings of the Railway Company, and especially upon those portions of said net earnings which have accrued or may accrue from the railways described in the Bill of Complaint, both those accrued prior to and during the Receivership in Cause No. 185, and those accrued and to accrue during the Receivership in Consolidated Cause No. 198, and upon all of the property of the Railway Company, superior in rank to the claims of the trustee and of the holders of mortgage bonds and coupons issued under the deed of trust sought to be foreclosed by the Farmers' Loan and Trust Company; that the net earnings of the railway described in the Bill of Complaint should be first devoted to the payment of the amounts so decreed, and, if they should prove insufficient to pay the amounts, then that the Court should decree the payment of said amounts out of any proceeds of sale of the property of the defendant Railway Company to be made under final decree (Record, pp. 86-88).

The Pacific Improvement Company, as assignee of the Lackawanna Company upon its petition, and by order of Court, dated February 5th, 1892, was made a co-petitioner with the Lackawanna Company (Record, pp. 96, 97).

This petition of intervention, with the answers of the Farmers' Loan and Trust Company, and of Moran Bros. *et als.*, intervening bondholders (Record, pp. 88 and 97, 98), was referred to William L. Prather as a special master "to take the accounts in said petition prayed for, and to investigate, and to find and report upon the facts as to the subject matter of said petition, and of the answers thereto" (Record, p. 98).

On the 13th of January, 1896, the Special Master filed his report upon the intervention of the Lackawanna Company finding the facts substantially as they have been hereinbefore stated (Rec., p. 98, *et seq.*) and especially finding as to the equitable nature of the

claim of the Lackawanna Company at page 104 of the Record as follows :

“ It appears that at the time when the contracts hereinbefore mentioned were entered into between said Lackawanna Company and the defendant railway company that the condition of the track of the defendant railway company was such that the demand for new rails upon the most worn portion of the roadway was practically imperative. For a number of years prior to December, 1882, only about 5,000 tons of new rails had been purchased. The road north from Houston for 90 miles was built in 1857-1861 and thence northward to Denison, 1867-1872. The Western division leading to Austin was constructed in part prior to 1861, and completed in 1873, and the Waco division was completed about 1875. The condition of these roads was bad, except such portions as had been relaid with 5,000 tons of rails purchased prior to December 28th, 1882. There was continual breakage of rails and wrecking of trains, the track was unsafe and was generally so regarded, not only by ‘ railroad men,’ but by the traveling public; the damage to merchandise, rolling stock, &c., was continuous, and the need for new rails appears to have been ‘ absolutely necessary as a preservation of human life, the loss of which was liable to occur at any moment.’

“ I find that when the aforesaid contracts were made with the said Lackawanna Company both seller and buyer expected the debts to be paid from the net income of the railway; that the credit extended under said contracts was at the request of and for the accommodation of the defendant railway company and upon its general credit. That said sales were made without any stipulation that security should be given by the

defendant company for said rails, or that payment therefor should be made out of any particular fund or in any particular way; that said sales were for an unusually large amount of rails, and the defendant was unable to pay cash therefor, and there was no other way of obtaining said rails except upon credit."

At the time of the Special Master's report, filed January 6, 1896, the Circuit Court had in the hands of its Receiver, or deposited in the registry of the court net income to the amount of \$362,855.37, which had accrued from the Waco and Northwestern Division alone between December 10, 1892, and September 3, 1895 (Rec., last few lines of p. 58, and last half of p. 65).

Upon this report a decree was entered on the 26th of February, 1896, dismissing the petition of intervention of the Lackawanna Company and its transferee, the Pacific Improvement Company, without prejudice to their rights under the intervention in the Consolidated Cause No. 198 (Rec., pp. 121 and 122).

From this decree an appeal was taken to the United States Circuit Court of Appeals for the Fifth Circuit, which court affirmed the decree of the lower court (Rec., p. 140). The intervention of the Lackawanna Company now comes before this court upon a writ of *certiorari*.

MATERIAL FACTS AND DATES.

October 30th, 1883. Date of contract under which rails were delivered.

February to May, 1884. Date of delivery of rails.

February 21st, 1885. Receivers appointed in Cause No. 185.

September 12th, 1885. Petition of intervention filed by Lackawanna Company in Cause No. 185. Ever since this date an intervention on behalf of the Lackawanna Company has been pending for the same claim in the various receivership proceedings.

May 26th, 1886. Order entered consolidating causes 198, 199 and 201 in one cause known as Consolidated Cause No. 198.

November 26th, 1886. Petition of intervention filed by Lackawanna Company in Consolidated Cause No. 198. Exceptions to report on this petition are still pending.

May 4th, 1888. Final decree of foreclosure in Consolidated Cause No. 198.

April 6th, 1889. Bill filed in present cause to foreclose Waco and Northwestern Division First Mortgage.

November 3d, 1891. Petition of intervention filed by Lackawanna Company in present cause. The same claim is made upon this intervention as was contained in the petition filed in Cause No. 185 on the 12th of September, 1885, and in the petition filed in Consolidated Cause No. 198 in November, 1886.

During the years 1883 and 1884 when the rails were contracted for and delivered \$2,386,400 interest was paid out on bonded indebtedness of the railway company. Of this sum upwards of \$1,300,000 was paid from income or current earnings, and out of the total amount, \$159,600 was paid as interest on the Waco and Northwestern Division First Mortgage Bonds (Rec., p. 119).

The receivers in Causes Nos. 185 and 198 received about \$32,000 for proceeds of iron rails replaced with the steel rails involved in this claim (Record, p. 104) and expended \$1,512,842.18 for purposes outside of their operating expenses to pay off the mortgage interest or to pay for rolling stock or betterments upon the mortgaged properties; and during the receivership in Cause No. 198 \$91,371 was paid under order of the court to holders of Waco and Northwestern Division First Mortgage Bonds, the order for such payment expressly stating that such payment was without prejudice to the rights of this intervenor (Rec., pp. 112 and 114).

The Waco and Northwestern Division constituted $11\frac{13}{100}$ per cent. of the Houston and Texas Central Railway system (Rec., p. 3).

At the time of the Special Master's report, filed January 6, 1896, the Circuit Court had in the hands of its Receiver, or deposited in the registry of the court, net income to the amount of \$362,855.37, which had accrued from the Waco and Northwestern Division alone between December 10, 1892, and September 3, 1895 (Rec., last few lines of p. 58 and last half of p. 65).

SPECIFICATION OF ERRORS.

FIRST. The court below erred in not adjudging and decreeing that the petitioners had a lien upon the income now in court of the Waco and Northwestern Division of the Houston and Texas Central Railway Company, for rails furnished by the Lackawanna Company to and laid upon said division, superior to any lien thereon of the Waco and Northwestern Division First Mortgage.

SECOND. The court below erred in not adjudging and decreeing that said petitioners had a lien upon the corpus of the property of said Division of said Railway Company superior to the lien of said mortgage.

THIRD. The court below erred in adjudging and decreeing that the petitioners had no lien for the rails so furnished as aforesaid upon the said income or property of said Division of said Railway Company.

FOURTH. The court below erred in not adjudging and decreeing that, if the petitioners had no lien upon the said income, the same should be distributed ratably between the petitioners and the creditors of the railway company secured by the said Waco and Northwestern Division First Mortgage.

FIFTH. The court below erred in adjudging and decreeing that the said Waco and Northwestern Division First Mortgage was a lien upon the income in court earned by said Division of said Railway Company.

FIRST POINT.

A materialman who furnishes to a railroad supplies which save and preserve the property and enable it to continue as a "going concern" has an equitable lien upon the income and the corpus of the property superior to that of the mortgage creditors.

In the consideration of this question it is useful to have continuously and distinctly in mind the character of a great railroad property and no better idea of it can be conveyed than that given by Mr. Justice BLATCHFORD in *Union Trust Co. vs. Illinois Midland Co.*, 117 U. S., 434, 455, when he said :

"A railroad and its appurtenances is a peculiar species of property. Not only will its structure deteriorate and decay and perish, if not cared for and kept up, but its business and goodwill will pass away if it is not run and kept in good order."

The situation of the Houston and Texas Central Railway Company at the time the rails in question were sold to it by the Lackawanna Iron and Coal Company is of importance. The facts in the case at bar make it somewhat different from the usual run of cases decided by this Court, which involve the doctrine of *Fosdick vs. Schall*, 99 U. S., 235, and the furnishing of the rails to the railway company was not the ordinary case of a periodical renewal of supplies to make good the usual wear and tear upon a railroad, or the sale of coal to furnish fuel for its engines. In this case, in addition to the fact that the rails furnished kept the railway company a "going concern," we find that the sale of the rails actually saved and preserved the property and enabled the railway company to continue its existence. The new rails not only permanently improved

the mortgaged property, but the railroad and its receivers realized a considerable sum of money from the sale of the old rails, which were replaced by those sold by the petitioner. As the record shows, the track of the railway company was worn out. Prior to the purchase of the rails from the Lackawanna Company it had become dangerous to travel upon the road and the general public hesitated to use it, even for the shipment of freight. It was doubtful if the railway could have continued longer in existence, and to preserve its property and continue in business it purchased the rails in question. There was substantially a retracking of the entire system. The Waco and Northwestern Division of the Houston and Texas Central Railway Company was fifty-eight miles in length. Nearly thirty-one miles of this division were relaid with rails furnished under the contract involved in this case, dated October 30th, 1883 (Rec., p. 104).

The Lackawanna Company, with a full knowledge of the situation, and appreciating the importance to the railway company of the supplies furnished, sold the rails, took no collateral security for the notes given for the amount due it, expected to be paid out of the income of the railway company as had been done under the first of the two prior contracts, and as was being done under the second, and relied upon the fact that its supplies saved and preserved the property for the benefit of the railway company, kept it a going concern and conferred an equal benefit upon its mortgage creditors, and that, by reason of such circumstances, there arose an equitable lien in its favor upon the property and more especially upon the income of the railway company, which gave it a preference over the mortgage.

The broad principle of equity which we think should control this case is that any man who furnishes to another at his request money, labor or supplies for the purpose of saving and preserving the

property of the latter is entitled to be repaid for his advances (whether such advances are in the shape of money, labor or supplies) before the other can take the benefit of his gain. As we understand it, such equitable principle and the equitable lien so created is as good against the mortgagee of the property preserved and saved as against the mortgagor, for (1) the mortgagee is equally benefited with the mortgagor by the supplies furnished, and (2) the mortgagee, by leaving the mortgagor in charge of the mortgaged property makes him his agent to create any lien necessary and proper to save and preserve the property and keep it a "going concern."

Fosdick vs. Schall (*supra*) was the first railroad foreclosure case which contained a statement of this equitable doctrine, but it has been often applied in foreclosure suits involving other property.

I.

PROPERTY SAVED AND PRESERVED BY MATERIALS AND SUPPLIES FURNISHED AT THE REQUEST OF THE OWNER IS SUBJECTED TO, AND CHARGED WITH, A LIEN AS AGAINST THE OWNER FOR THE VALUE THEREOF.

Before, therefore, taking up the discussion of Fosdick vs. Schall and the subsequent kindred cases decided by this Court involving railroad foreclosures, it may be useful to refer to various cases which sustain the principle that any service rendered at the request of the owner which saves and preserves a property is in the nature of a salvage service and creates an equitable lien upon the property in favor of the party performing the service because of the fact that the owner of the property would have had nothing but for the service rendered and must, therefore, before taking advantage of such service, repay it.

In *Shearman vs. Assurance Co., L. R., 14 Eq., 4*, it appeared that one Thomas Pocknall had insured his life in the defendant company, and deposited the policy with the plaintiff *as a security for a debt* due from him to the plaintiff. Subsequently, Pocknall was adjudicated a bankrupt, which relieved him from any obligation to pay the premiums on the policy. He, however, continued to pay the premiums after his bankruptcy and up to the time of his death. A bill was filed by the plaintiff to recover the amount of the insurance money. The widow and legal representative of Pocknall also claimed the money, which was paid into court. It was eventually held that the plaintiff was entitled to the money, but must repay to the estate of Pocknall the premiums paid by him subsequently to the bankruptcy, on the ground that they were so much *salvage money*, and that the plaintiff would have had nothing at all but for the money advanced by Pocknall out of his own pocket. The Master of the Rolls said at p. 5 :

“That the plaintiff was clearly entitled to the policy moneys, but that the premiums paid subsequently to the bankruptcy were in the nature of *salvage moneys*, and that the plaintiff must repay them to Mrs. Pocknall, with interest at four per cent.”

It is true that in the case cited the property mortgaged was an insurance policy and not a railroad and that the supply man furnished money and not rails to save and preserve the mortgaged property, but aside from such apparently immaterial distinctions it is not clear why the case is not on all fours with the case at bar.

In the *Matter of Tharp, 2 Sma. & Giff., 578*, the Lord Chancellor, in deciding that the consignee of West India estates had a right to be reimbursed his

expenditure out of the rents of the English estates of the same owners, said at page 578 :

“ In Ireland, it is a very common equity to have, as a prior charge to all other incumbrances, what is called salvage money : Where a leasehold estate, or an estate held for lives to which half a dozen people are entitled in succession, many of them being mortgagees, according to certain priorities, the last man of all who is entitled after everybody, being in possession, redeems, I may say, the estate by paying the landlord, who otherwise would have recovered the estate and taken it from everybody : *this payment is what is called salvage money. That is an established equity, and a very proper equity. He that pays the salvage has a prior encumbrance to every other charge and interest, because, so far as any interest is left to anybody beyond the charge, it is acquired by that payment, in the shape of redemption money.*”

In *Minnitt vs. Lord Talbot*, L. R., Ir. 1 Ch. D., 143, money was advanced by members of a club to pay for improvements to the buildings of the club house and a bill was filed to recover it. The prayer of the bill was that the plaintiffs might be declared entitled to an equitable lien for the sums found due them upon the premises and furniture therein and all other property of the club. This lien was allowed by the Master of the Rolls, who said at page 152 :

“ In the name of common sense, could the Club have said ‘ we will not allow you to be repaid it, for we did not authorize you to advance it ; though it is true we authorized the improvements to be made, we only authorized them to be so made by borrowed money ; we have availed ourselves of them, we have played in the new billiard rooms and slept in the new bedrooms built with your

money, but we will not recoup you?' I think that the club could not be listened to for a moment in putting forward such an unconscionable proposition."

In the important and complicated litigation of *Manix, Assignee, vs. Purcell*, 46 Ohio St., 102, one of the questions was as to the right of a creditor to be reimbursed for certain repairs and improvements made by him upon a Roman Catholic cathedral at the request of the archbishop. There was apparently no agreement whatever as to any equitable lien, and an examination of the case, having regard to all the circumstances of the varied transactions in which over three millions of dollars belonging to the congregations of various churches were lost, precludes the idea that there was any understanding between the archbishop and the creditor, as to any lien in favor of the latter, as against the cathedral. It was held, that the claim should be paid out of the property, *upon the ground that the cathedral had been preserved by the services rendered*. The Court said, at page 147 :

"The claim of John G. Hendricks, another cross-petitioner below, and cross-petitioner in error in this court, stands upon ground distinct from all others. He obtained a judgment against John B. Purcell, also after the assignment, upon a claim composed in part of an indebtedness for money deposited to bear interest, and in part for improvements and repairs placed upon the cathedral, *and for its preservation*, at the request of the archbishop. We are all in accord upon the proposition that the latter claim possesses peculiar merit, upon the principal that the trust property should answer for the reasonable expense incurred in *its preservation* and necessary repair and improvement. We are not in accord, however, as to the means of effectuating this right. A majority of

the Court is of opinion that the remedy may be granted in this case, and for this purpose the judgment as to this claim is reversed, and the cause remanded for further proceedings upon this branch of the controversy."

Mr. Justice STORY in his work on equitable jurisprudence gives the doctrine for which we contend as follows :

" But courts of equity have not confined the doctrine of compensation or lien for repairs and improvements to cases of agreement or of joint purchases. They have extended it to other cases where the party making the repairs and improvements has acted *bona fide* and innocently, and there has been a substantial benefit conferred on the owner, so that *ex æquo et bono* he ought to pay for such benefit."

2 Story on Eq. Juris., p. 582, § 1237 (13th Ed).

The principle stated by Mr. Justice STORY seems to have met with the approval of the Court of Appeals of the State of New York in the case of *Perry vs. Board of Missions, etc.*, of Albany, 102 N. Y., 99. The plaintiff Perry advanced money to pay for certain improvements and repairs upon a house owned by the defendant. He had no specific lien whatever of any kind upon the premises, but the Court of Appeals held that the particular facts in the case entitled him to an equitable lien upon the premises, saying at pages 104 and 105 :

" It is objected by the appellant that the plaintiff is not, by reason of any of these facts, entitled to an equitable lien upon the premises for the benefit of which they were made. We are of a different opinion.

" The principle upon which a Court holds that

a vendor, who has not been paid, is entitled to a lien on the land sold is that it would be contrary to natural justice to allow a purchaser to retain an estate which he has not paid for, and it seems very clear that there is a like natural equity in favor of the plaintiff. It is true he did not sell the estate, but he added to it, *and by his expenditures upon it fitted it for the purpose for which it was intended.* A lien for the price of an estate sold exists without *any special agreement*, and by virtue of a doctrine merely of a court of equity. Here there is a special agreement, and also a case to which the doctrine applies. * * *

"SECOND. The plaintiff's case is within the general doctrine of equity, which gives a right equivalent to a lien, when, in no other way, the rights of parties can be secured. *The advances were directly for the benefit of the real estate; they were approved by the convention by whose directions the title was conveyed to the defendant, but neither the convention nor the defendant have incurred any corporate liability, and, while it may be said that the advances were made on the promise of, or in the just and natural expectation, that a mortgage would be given, it is also true that they were made on the credit of the property, for the improvement of which they were expended. The repairs and improvements were permanently beneficial to it, made in good faith, with the knowledge and approbation of the parties interested, and accepted by them, not as a gratuity, but as services for which compensation should be given. The plaintiff's right to remuneration is clear, and unless the remedy sought for in this action is given, there will be a total failure of justice.*"

In *Smith vs. Smith*, 51 Hun, 164 (affirmed in 125 N. Y., 224), the plaintiff erected a building upon land of the defendant, increasing the value of the

property to a considerable extent. There was an oral understanding between them that, if the plaintiff became in any way embarrassed, he might sell the building. Upon the defendant refusing to permit the sale of the property, the plaintiff brought an action to establish an equitable lien thereon for the money expended by him upon the building. This equitable lien was sustained by the Court, and its judgment affirmed on appeal, the General Term saying, at page 169 :

"This right or lien is founded * * * upon the fact that it would be contrary to natural justice to allow the defendant to retain the building erected upon her land by the plaintiff without compensating him for the money thus expended. The plaintiff expended his money for the direct benefit of the defendant's real estate. The building erected by him was a permanent improvement to such real estate. * * * The plaintiff's right to receive the amount thus expended by him seems to be clear, and unless the remedy awarded in this action be upheld, there will be a failure of justice. We think the plaintiff's case is within the doctrine held in the cases cited, which gives a right equivalent to a lien where the rights of the parties can be secured in no other way."

In *Bright vs. Boyd*, 1 Story Rep., 478, one of the questions was whether a *bona fide* purchaser of real estate, whose title afterwards turns out to be defective, is entitled to compensation for improvements made upon the land. It was held by Judge STORY that he was. In the course of his opinion he says at page 495 :

"Take the case of a vacant lot in a city where a *bona fide* purchaser builds a house thereon, enhancing the value of the estate to ten times the original value of the land under a title apparently

perfect and complete; is it reasonable or just that, in such a case, the true owner should recover and possess the whole without any compensation whatever to the *bona fide* purchaser? To me it seems manifestly unjust and inequitable thus to appropriate to one man the property and money of another who is in no default. The argument, I am aware, is that the moment the house is built it belongs to the owner of the land by mere operation of law; and that he may certainly possess and enjoy his own. But this is merely stating the technical rule of law, by which the true owner seeks to hold what, in a just sense, he never had the slightest title to; that is, the house. It is not answering the objection, but merely and drily stating that the law so holds. But then admitting this to be so, does it not furnish a strong ground why equity should interpose and grant relief? * * *

"To the extent of the charge, from which he has been thus relieved by the purchaser, it seems to me that the plaintiff, claiming under the purchaser, is entitled to reimbursement in order to avoid a circuitry of action to get back the money from the administrator. * * * I confess myself to be unwilling to resort to such a circuitry in order to do justice, where upon the principles of equity the merits of the case can be reached by affecting the lands directly with a charge to which they are *ex æquo et bono* in the hands of the present defendant clearly liable" (p. 498).

Admiralty decisions are of course in no way controlling in a court of equity, but the reason of the priority of maritime liens for repairs and supplies furnished a vessel in a foreign port, over a prior mortgage, is not far from the reason of the equitable rule in *Burnham vs. Bowen*, 111 U. S., 776—viz., that by such supplies and repairs the ship is kept a "going concern;" but, in any event, the following quotations from the

admiralty courts are interesting as stating the principle, which we seek to establish, upon equitable grounds in no way connected with admiralty and maritime liens.

In *Poland vs. The Spartan*, 1 Ware, 134, 138, Judge WARE said :

“ It is a general principle of law, extending to a great variety of cases, that a person who has, by his own labor, thus added a new value to a specific article, has a lien on the article for the value of his service. It is a right consonant to all ideas of natural equity, and is highly favored by the law. * * * Another general principle is that, when this sort of confusion of goods is produced at the request of the general owner, he that has given the last increment of value to the article is entitled to be first satisfied out of the common stock.”

In *Stevens vs. The Sandwich*, 1 Pet. Adm., 233, 238, the point is well put in these words :

“ The reason of the lien to ship carpenters for repairs, independent of considerations of policy, even among contending mortgagees, is that such services *preserve the specific thing from destruction*, and securing such subsequent creditors does not injure prior mortgagees or creditors, since the pledge is increased in value, in proportion to such services.”

In *The Felice B.*, 40 Fed. Rep., 653, certain repairs and supplies were furnished the vessel *after the breaking up of the voyage*. Thereafter the vessel was libeled by the holder of a bottomry bond, and sold by the Marshal. Upon the distribution of the proceeds, a question arose as to the priority of the claim of the materialmen and the lien of the bottomry bond. It was held by Judge BENEDICT that, on equitable principles, the materialmen had a prior claim, for the reason that

they had by their repairs increased the value of the ship. He said (at p. 654) :

“ As to the demand of the materialmen, objection is made in behalf of the bottomry holder that he is entitled to priority in payment over any debts due the materialmen for repairs and supplies, and for services rendered to the vessel subsequent to the breaking up of the voyage. In regard to these demands, which consist of actual repairs put upon the vessel, and which tended to increase her value, equity requires that such demands should be paid prior to the bottomry, for the reason that these repairs have gone to enhance by so much the proceeds of the sale of the vessel now in court, and cannot with justice be applied to the payment of the bottomry.”

Although the property involved in the cases just cited was a ship, yet the decision was placed upon grounds of equity, and not admiralty law, and the words of Lord CRANWORTH, in *Bristowe vs. Whitmore*, 9 H. L. C., 391, 404, are most applicable :

“ The ground on which I rest this opinion has no reference to any law peculiarly applicable to shipping. * * * The principle which must, I think, govern this case is one of universal application ; namely, *that where a contract has been entered into by one man as agent for another, the person on whose behalf it has been made cannot take the benefit of it without bearing its burdens.*”

In the opinion of the Circuit Court of Appeals in the present case, at page 140 of the Record, it is sought to weaken the position taken by the Lackawanna Coal Company by referring to the case of *Railway Company vs. Cowdry*, 11 Wall., 459, 482, in which Mr. Justice BRADLEY said : “ As to the other point giving priority to the last creditor for aiding to conserve the thing, all that

is necessary to say is that the rule referred to has never been introduced into our laws except in maritime cases, which stand on a particular reason."

An examination of the Cowdry case and of the other cases referred to by the Circuit Court of Appeals shows that the claims in each were for materials used in the *original construction* of a railroad and not in its repair, which is a very different proposition from the one now before the Court. It was said in the Cowdry case, at page 480 :

" On the part of Robert Pulsford it is objected that the decree does not give him a priority on that portion of the road which was laid with his iron. He contends that he is entitled to this * * * because his capital applied to the road conserved it and rendered it capable of being operated, which it would not have been otherwise ; hence, on the principle adopted by the civil and maritime laws of awarding priority to the last creditor who furnished necessary repairs and supplies to a vessel, he is entitled to priority. The counsel for Pulsford has furnished us with a very ingenious and learned argument on these points, but we cannot yield to their force."

It is sufficient to say that the argument advanced in favor of Pulsford in the Cowdrey case would have been without force even in an admiralty court, and if the subject matter of the foreclosure suit had been a ship and not a railroad. It has never been held in admiralty that a materialman who furnished the material for the construction of a ship had under the maritime law a lien which displaced a prior mortgage. The only lien known in admiralty for supplies and repairs, which is given precedence over a prior mortgage, is that which results from the furnishing such repairs and supplies in a foreign port as will enable the ship to continue her voyage, keep her a going concern and place her in a position to earn money to pay the interest on the mortgage.

In other words, the argument that materials used in the *original construction* of a property should be paid for ahead of a prior mortgage thereon, is no more recognized in a court of admiralty than it is in any other court, and for the very obvious reason that what goes into the original construction of a ship or a railroad, cannot possibly be said to preserve and keep in existence such ship or railroad, which is the basis both of the admiralty and equitable lien.

It will be observed how careful this court is in all the cases referred to by the Circuit Court of Appeals in its opinion in this case to indicate the distinction between material furnished for the *original construction* of a railroad and material furnished to preserve and keep in order a railroad already constructed and to keep it a "going concern," and this court has never yet held that the principle of admiralty law referred to did not apply to the case of supplies furnished a railway company in order that it might continue in existence.

In the case of Toledo, &c., Railroad Co. vs. Hamilton, 134 U. S., 296, an equitable lien superior to the mortgage was claimed for work done in the *original construction* of property belonging to the railroad company. This lien was not sustained, but the court distinguished the case from an equitable lien for material and work which saves and preserves a railroad as a going concern. This material difference was brought out at page 301, as follows :

"Neither did the fact of the construction of the dock, and the consequent improvement of the mortgaged property, give, as reported by the master, to Hamilton an equitable lien prior in right to the lien of the mortgage, or furnish equitable reasons why the legal priority belonging to the mortgage should be displaced. It is true cases have arisen in which, upon equitable reasons, the priority of a mortgage debt has been displaced in favor of even unsecured subsequent

creditors. See *St. Louis, Alton, &c., Railroad vs. Cleveland, Columbus, &c., Railway*, 125 U. S., 658, 673, in which many of these cases are collected and the equitable principles underlying them stated. But those principles have no application here. *The work which Hamilton did was in original construction, and not in keeping up, as a going concern, a railroad already built. The amount due him was no part of the current expenses of operating the road. There was, as to him, no diversion of current earnings to the payment of current expenses.*

"The distinction is so well expressed by Mr. Justice BLATCHFORD, in giving the opinion of the court in the case of *Porter vs. Pittsburg Steel Co.*, 120 U. S., 649, 671, that it is sufficient to quote his language : 'The claims of the appellees are for the *original construction* of the railroad. This is not a case where the proceeds of the sale of the property of a railroad, as a completed structure, open for travel and transportation, are to be applied to restore earnings, which, instead of having been applied to pay operating expenses and necessary repairs, have been diverted to pay interest on mortgage bonds and the improvement of the mortgaged property, the debts due for the operating expenses and repairs having remained unpaid when a receiver was appointed. The equitable principles upon which the decisions rest, applying to the payment, out of the proceeds of the sale of railroad property, of such debts for operating expenses and necessary repairs, are not applicable to claims such as the present, accrued for the *original construction* of a railroad while there was a subsisting mortgage upon it.' "

The application of the admiralty rule in equity cases was recognized by Judge BRADLEY in the case of the *Provident Institution vs. Jersey City*, 113 U. S., 506.

It is very evident that the citation from Judge BRADLEY's opinion in the Cowdrey case (*supra*), which was relied upon by the court below, was intended by Judge BRADLEY to apply only to the facts of that particular case, where an equitable lien on the principle of the admiralty law was claimed for work and materials used in the *original* construction of a railroad. The views of Judge BRADLEY upon the question, when arising in a case like the present, is shown when he said in *Provident Institution vs. Jersey City*, 113 U. S., 506, 516, that

“ The law which gives to the last maritime liens priority over earlier liens in point of time is based on principles of acknowledged justice. *That which is given for the preservation or betterment of the common pledge is in natural equity fairly entitled to the first rank in the tableau of claims.*”

In the case of *Williams vs. Gibbes*, 20 How., 535, the doctrine which we now urge was the real ground of the decision, viz., that a lien was created for money advanced for the preservation of property. The facts were these: One Williams had a share in the Baltimore Company, which company had a claim against the Government of Mexico. He became insolvent and his assignee sold and assigned the share to a man by the name of Oliver. Oliver, and his executors after his death, prosecuted the claim of the Baltimore Company against the Mexican Government, and recovered a large sum of money. It was subsequently held that the assignment of Williams' share in the Baltimore Company to Oliver was invalid, and that the interest therein remained in Williams and passed to his legal representative, the complainant, who brought suit to recover the proceeds of Williams' share. The question was as to the right of Oliver's executors to deduct the costs and expenses incurred in getting this sum of money and the value of Oliver's service in that

regard. The lower Court held that such expenses, etc., were in equity entitled to be deducted before paying over the money and the decree of the Court was affirmed on appeal. The Court said :

“ The proofs show that Oliver appointed agents to represent him at the Government of Mexico as early as March, 1825, and that these agencies were continued from thence down till his death in 1834 ; and that during all this time he kept up an active correspondence with them and others, and with our ministers at Mexico, and with his own government, on the subject. The justice of these claims had been acknowledged by the Government of Mexico as early as 1823-4, but no provision was made for their payment. They were regarded as of very little value, from the hopelessness of their recovery ; and it is perhaps not too much to say, upon the evidence, that in the absence of the vigorous and efficient prosecution of them by Oliver, they would have been worthless * * * The estate of Williams has never expended a dollar towards recovering it ; nor has Oliver ever received any compensation for his services. The amount may seem large, but we cannot say the Court below was not warranted in allowing it upon the proofs in the case of the great service rendered, and of the customary charges in similar cases ” (p. 540).

“ All the services and expenses, therefore, of Oliver, in his lifetime, in the prosecution of the claims of the Baltimore Company against the Government of Mexico, and of the litigation since encountered by his executors in respect to the share, have resulted in securing the proceeds of the same to the estate of Williams, the original shareholder. Williams in his lifetime, and his legal representative since, down till the fund was in court awaiting distribution, had taken no steps

for its recovery, nor had they been subjected to any expense. The whole of the services had been rendered, and expenses borne, by Oliver and his executors; and the question is whether, upon any established principles of law or equity, the Court below were right in taking into the account in the settlement between the parties these services and expenses. We are of opinion they were (p. 537). * * *

“ But it is said that these suits were defended by the executors, while claiming the fund in right of their testator, and hence for the supposed benefit of his estate; that the defense was not made in their character of trustees, and cannot, therefore, be regarded as a ground for charging the estate of Williams with the costs of the litigation.

“ The answer to this view is that, although in point of fact the defense was made under the supposition that the fund belonged to the estate of Oliver, yet, in judgment of law, it was made by them as trustees, and not owners, as subsequently judicially ascertained; and, as the costs and expenses were properly incurred in the protection and preservation of the fund, it is but just and equitable they should be made a charge upon it.

“ The misapprehension as to the right cannot change the beneficial character of the expense, when indispensable to its security. * * *

“ Another principle which we think applicable to this case is to be found in a class of cases where a *bona fide* purchaser, for a valuable consideration, without notice, has enhanced the value of the property by permanent expenditures, and has been subsequently evicted by the true owner, on account of some latent infirmity in the title. It is well settled, if the true owner is obliged to come into a court of equity to obtain relief against the purchaser, the Court will first require reasonable compensation for such expenditures to be made,

upon the principle that he who seeks equity must first do equity (2 Story Eq., Secs. 799 and 7996; 6 Paige R., 403, 404; 1 Story Rep., 494, 495).

"A kindred principle is also found in a class of cases where there has been a *bona fide* adverse possession of the property tacitly acquiesced in by the true owner. The practice of a court of equity in such cases does not permit an account of rents and profits to be carried back beyond the filing of the bill (8 Wheat., 78; 27 E. L. and E. Rep., p. 212; 7 Ves., 541; 1 Ed. Ch., 579). This principle is applicable where the person in possession is a *bona fide* purchaser, and there has been some degree of remissness, or negligence, or inattention on the part of the true owner, in the assertion of his rights" (pp. 538 and 539).

The cases to which we have referred the Court would seem to conclusively show that the Lackawanna Company had an equitable lien as against the railway company for the value of the rails sold. This lien is against and upon the income and corpus of the property of the railway company which has been saved, preserved, improved and made valuable by the rails sold to the railway company by the Lackawanna Company, and is based upon the theory, (1) that any improvement put upon property by one not the owner, at the owner's request, creates a lien in his favor as against the owner for the reason that, as between the two, equity can see no justice in "appropriating to one man the property and money of another," and (2) upon the doctrine that services rendered, by which property is saved and preserved from total or partial destruction, must be repaid before the party benefited can take advantage of his gain.

II.

THE MORTGAGE CREDITORS, BY LEAVING THE RAILWAY COMPANY IN POSSESSION OF THE PROPERTY, IMPLIEDLY AUTHORIZED IT TO CREATE ANY LIENS THEREON WHICH MIGHT BE NECESSARY TO KEEP UP THE PROPERTY, AND ENABLE IT TO CONTINUE TO EARN THE INTEREST UPON THE MORTGAGED DEBT.

If we are correct in our conclusion that the circumstances of this case created an equitable lien in favor of the Lackawanna Company against the railway company for the value of these rails, the next question which presents itself is whether such lien is entitled to a preference over a prior mortgage.

The reasons why liens (and it is immaterial whether such liens are equitable or common law or of any other nature) created by a mortgagor in possession of property should be preferred to the mortgage are sufficiently obvious and require no extended discussion.

Stated briefly they are as follows :

FIRST. When the mortgagee leaves a mortgagor in possession of property such as a railroad, a ship or any large plant needing constant repairs, alterations and improvements, in order to keep the property in a state of efficiency and to enable it to continue a going concern and to earn the interest on the mortgage debt, he intends that the mortgagor shall care for the mortgaged property and make the necessary and proper repairs required to keep the ship or the railroad or whatever it is a going concern. It is always so understood by all the parties concerned ; the mortgagee, the mortgagor and the materialman. In other words, the mortgagee practically makes the mortgagor his agent to take care of the property and to create thereon whatever liens may be necessary to preserve it in an efficient state, and is therefore bound by any such lien and must pay the same before he can take either the *corpus* of the property or the income thereof.

SECOND. The benefit rendered by the materialman is

to the property itself. As is readily apparent, such benefit enures to the mortgagee quite as much as it does to the mortgagor. If the mortgagor cannot take advantage of another man's work, materials and money put into his property without payment, why should not the same equitable principle apply to the mortgagee? If the owner cannot stand by and see money or materials incorporated into and made part of his property, and the same saved from destruction thereby, without the payment for such money and materials becoming a charge upon the property because of the benefit accruing to him therefrom, it would seem as if the mortgagee, who has made the owner his agent to take care of such property, must be equally bound, and unable to take advantage of that which preserved his property without paying therefor.

As we understand it, the only element which it is necessary to find in a case of this character, in order to make the lien of a materialman a preferred claim to a prior mortgage, is that the repairs and materials furnished were necessary in order to keep the property a going concern. That is to say, all cases of repairs might not create a claim ahead of the mortgage. Take the case of a mortgaged hack, which was the property involved in a decision by Mr. Justice GRAY, hereafter referred to. If the mortgagor had rubber tires put upon the wheels, it might be said that the mortgagee never authorized the mortgagor to create a lien upon the hack for any such purpose, as it was not a necessity in order to keep the hack a "going concern," but if the spokes of the wheel were broken in some street collision and the mortgagor had them repaired, it would seem as if the materialman's lien would be preferred to the mortgage for the reason that the repairs were absolutely necessary in order to keep the hack "a going concern" and save the property from becoming a worthless wreck. In other words, the moment it appears that the materials furnished were necessary in order to save the property mort-

gaged and keep it a going concern, that moment the mortgagee is presumed as a matter of law to have authorized the mortgagor to incur the expense of procuring them, and the lien arising from such purchase against the mortgagor is to be preferred to the lien of the prior mortgage for the reasons we have heretofore stated.

In *Hammond vs. Danielson*, 126 Mass., 294, the plaintiff, the mortgagee of a hack, brought a replevin suit to recover possession of the hack from the defendants, who had made repairs thereon at the request of the mortgagor. The defendants claimed to have a lien upon the hack which entitled them to preference over the prior mortgage. Mr. Justice GRAY, then sitting on the Supreme Bench of Massachusetts, sustained the claim and said (at p. 296) :

“ The subject of the mortgage is a hack—that is to say, a carriage let for hire ; described in the mortgage as ‘ now in use ’ at certain stables ; and which, as the parties have agreed in the case stated, the mortgagor retained possession of and used agreeably to the terms of the mortgage. It was the manifest intention of the parties that the hack should continue to be driven for hire, and should be kept in a proper state of repair for that purpose, not merely for the benefit of the mortgagee [mortgagor], but for that of the mortgagor [mortgagee] also, by preserving the value of the security and affording a means of earning wherewithal to pay off the mortgage debt. The case is analogous to those in which courts of common law, as well as of admiralty, have held, upon general principles, independently of any provision of statute, that liens for repairs made by mechanics upon vessels in their possession take precedence of prior mortgages.”

Tucker vs. Werner, 49 N. Y. State Reporter, 571, was a similar case to that just cited. The plaintiff brought a

replevin suit to recover the possession of a buggy upon which he held a mortgage. The defendant claimed that he should first be paid the value of the repairs he had made upon the buggy and that he had a lien therefor ahead of the prior mortgage. The Court held that defendant clearly had a lien against the mortgagor and that the mortgagor, being left in possession of the buggy, was impliedly authorized by the mortgagee to keep it in repair and that defendant's lien had precedence of the mortgage. The Court said at page 572 :

" It may also be assumed, from the nature of the repairs, as shown by the bill, and the character of the property, in constant use, that such repairs were necessary, *useful for its preservation* and enhanced its value. If we are right in these inferences, we have a case where the mortgagee authorized a use of the property, clothed the mortgagor with apparent ownership, and where the work done has added value to the property."

Thereafter in discussing and approving the case of *Hammond vs. Danielson (supra)*, decided by Mr. Justice GRAY, which had been stated by counsel to be unsound, the Court made the following not uninteresting remarks at page 574 :

" It is claimed that this decision is not sound and has in fact been overruled. Its unsoundness is claimed to exist in the fact that it applies to the case the doctrine of maritime liens, but the basis upon which maritime liens are upheld grows out of the fact that they are essential to the preservation of the vessel, that it may be used in the prosecution of its voyage, thus earning money with which to pay the mortgage debt, and also the difficulty of procuring needed repairs in a foreign port, unless the vessel were the pledge of payment, relieved from

other burdens. But what difference in principle can there be where a carriage is used for the purpose of earning money to pay a debt *and the repairs are essential for the preservation and the continuance of earning power?* The article may be the very thing which earns the money, like the hack, or it may be a vehicle by which the individual is enabled to carry on an industry from which he earns what he is obligated to pay. In either event is always found some one of the principles upon which the lien rests, and sometimes they are combined, as where the repairs have added value to the property and thereby enhanced the security, *or the repairs have preserved the property to enable it to pay the security."*

The arguments and reasons which support the creating of a lien in admiralty for supplies furnished a ship which enabled her to continue a "going concern," complete her voyage and reach her home port, would seem to apply with equal force to supplies furnished a railroad which preserve its property, keep it on its feet and enable it to continue a "going concern." The reasons being the same in each case it would seem as if the rule should be the same, without regard to the fact that the questions arise in different branches of the law. Equity and Admiralty are, however, governed by much the same principles in their broad treatment of such a question as is here presented, and the former is not averse to borrowing its reasons and its rules from the latter.

The plaintiff in *Scott vs. Delahunt*, 65 N. Y., 128, brought an action to foreclose a lien for repairs upon a canal boat. The owner and the mortgagees of the boat were made defendants. The mortgagees alone defended. The owner had purchased the boat subject to the mortgage and was running her as master and owner when she foundered and sank and required re-

pairs to put her in condition for navigation. It was held that the lien of the materialman was to be preferred to the mortgage and it was said in the opinion at page 130 :

“ Under such circumstances I am of opinion that plaintiffs’ lien has priority over defendants’ mortgage. *The mortgagees having allowed the owner to continue in the apparent ownership of the boat, making her a source of profit and a means of earning wherewithal to pay off the mortgage debt, the relation so created by implication entitles the owner to do all that may be necessary to keep her in efficient state for that purpose.* The boat having been damaged and rendered unfit for use, the owner did that which was obviously for the advantage of all parties interested ; he put her into the hands of the plaintiffs to be repaired, and, according to all ordinary usage, they ought to have a right of lien on the boat so that those who are interested in her and who will be benefited by the repairs should not be allowed to take her discharged of the lien. Looking to the rights and interests of the parties generally, it cannot be doubted that it is much to the advantage of the mortgagee in such case that the mortgagor or owner should be held to have power to confer a right of lien on the boat for repairs necessary to keep her fit for navigation.”

In *Williams vs. Allsup*, 10 C. B., N. S., 416, the mortgagor of a vessel was left in possession of her and the mortgagee in no way interfered with her management and control. Repairs upon the ship became necessary and the mortgagor had them made by the defendant. Upon the mortgagor being in default in the payment of interest, the plaintiff (being the mortgagee), on examining into the matter, learned

that the ship was in the hands of the defendant, who was repairing her. The plaintiff demanded possession of the ship. The defendant refused to give her up, unless he was paid for the repairs he had made. The question before the Court was, whether the mortgagee was entitled to the possession of the vessel without paying for the repairs. It was held, that the mortgagee must pay for the repairs before he could have the vessel.

It is to be observed that the lien for repairs was not a maritime lien, but a common-law lien against the mortgagor. The reasoning of the Court proceeded entirely upon the theory that the mortgagor acted as the agent of the mortgagee, and that what was done had benefited the security of the mortgage debt. ERLE, C. J., says at page 426 :

" The mortgagee having allowed the mortgagor to continue in the apparent ownership of the vessel, making it a source of profit and a means of earning wherewithal to pay off the mortgage debt, the relation so created by implication entitles the mortgagor to do all that may be necessary to keep her in an efficient state for that purpose. * * * The vessel has been kept in a state to be available as a security to the mortgagee, by her destruction being prevented by the repairs which the defendant has done to her. * * * It is to be observed that the money expended in repairs adds to the value of the ship."

WILLES, J. (at p. 427), said :

" By the permission of the mortgagees the mortgagor has the use of the vessel. He has, therefore, a right to use her in the way in which vessels are ordinarily used. * * * It seems to me that the case is the same as if the mortgagees had been present when the order for the repairs was given.

To that extent I think the property of the mortgagees is impliedly modified."

In the Canada, 7 Sawy., 173, it was held by Judge DEADY that, upon general principles of law and right, one furnishing supplies to a vessel who has no maritime lien therefor and no lien under any State law is entitled to a preference over the mortgagee of the vessel. He says at page 188 :

" Apart from the provision of the New York Statute preferring the lien of the materialman to that of the mortgage, I think it clear upon general principles of law and right, that it is entitled to such preference. A mortgagor in possession represents the mortgagee, and in contracting debts for necessities is, therefore, authorized to bind his interest in the vessel for their payment, so far as the law gives a lien therefor. *In this respect there is an implied agency between them. Necessaries supplied the vessel through the agency of the mortgagor promote the interest of the mortgagee as well as that of the mortgagor, either by enabling the latter to navigate her and thus earn money to pay the indebtedness due the former, or to preserve her value as a security therefor.*"

It is true that, in the extract from Judge DEADY's decision just quoted, he uses the words "so far as the law gives a lien therefor," but the supplies in the case before him were furnished the vessel in her home port upon the request of the owner, so that there was no maritime lien therefor, and he expressly declares that he is considering the question apart from any lien given by the law of New York, the home port of the vessel. But the law of equity gives an equitable lien and the reasoning of Judge DEADY would seem to be perfectly applicable in the present case.

In *White vs. Smith*, 44 N. J. L., 105, 113, the plaintiff, owner of a wagon, allowed her husband to use it in his

business. It became worn out and the husband had it repaired. The defendant assumed that the husband owned the wagon and charged the repairs to him and refused to deliver the wagon unless his charges were paid. The plaintiff thereupon brought an action of trover and the defendant claimed a lien for the amount of his charges. The defendant's claim was sustained upon the ground that plaintiff had authorized her husband to have the repairs made and the wagon kept in running order. As was said by the Court at the end of a well-considered opinion :

“ I think it clear, on the facts certified by the Court below, that the husband had authority from the wife—implied from the manner in which she permitted the wagon to be used—to have the repairs done ; and, if so, the property became by law subject to a lien for the workman's charges.”

It is not clear just what objection can be raised by the counsel for the respondents to the authorities showing that a lien which displaces the mortgage arises for necessary repairs, etc., to a mortgaged property incurred to preserve the same and keep it a “ going concern,” and it may be argued that in some of the cases cited the liens referred to are common-law liens, and not equitable liens. This may be so, but we do not understand that such an argument is of any importance. The question is : Has any lien been created against the property itself and against the owners of the property ? If so, then it is indifferent whether such lien is an equitable lien or a common-law lien. If the lien against the property is in existence, then, whatever its character, so long as it was for some necessity furnished to save and preserve the property and keep it a “ going concern,” it must be preferred to the prior mortgage. The point in all the decisions was not that the lien mentioned was a *common-law* lien as opposed to an *equitable* lien, but that

the material furnished or work done, from which the lien resulted was something which saved and preserved the property mortgaged and kept it a "going concern."

We, therefore, submit that the furnishing of the rails by the Lackawanna Company to the railway company created a lien in favor of the former company against the railway company and its property, and the income therefrom, and that such lien is to be preferred to the mortgage upon the ground that the mortgage creditors impliedly authorized the railway company to create such lien, and have received the benefit of the rails.

III.

THE MORTGAGE FORECLOSURE CASES INVOLVING THIS QUESTION HERETOFORE DECIDED BY THIS COURT.

It is true that Chief-Justice WAITE, in his opinion in *Fosdick vs. Schall* (*supra*), at page 252, says that "railroad mortgages and the rights of railroad mortgagees are comparatively new in the history of judicial proceedings. They are peculiar in their character and affect peculiar interests," and questions arising under railroad foreclosures are sometimes discussed as if railroad mortgages were *sui generis*, and the rules applicable to ordinary mortgages did not apply to them, and this argument may be urged by the other side to show that the cases to which we have referred have no weight in this discussion.

As we understand it, however, the reasons for the application of this rule are stronger in a railroad case than in any other, because of the character of the property involved. In fact, it was said by Mr. Justice LAMAR in *Wood vs. Guarantee Trust Co.*, 128 U. S., 416, 421, that "*the doctrine of Fosdick vs. Schall has never yet been applied in any case, except that of a railroad.*" The case lays great emphasis on the considera-

tion that a railroad is a peculiar property, of a public nature, and discharging a great public work. There is a broad distinction between such a case and that of a purely private concern. We do not undertake to decide the question here, but only point it out." It would seem, therefore, that cases such as we have cited and relating to "purely private" concerns and interests in which this doctrine has been applied are the strongest kind of authority in the present discussion, and that *a fortiori* the principle would be upheld in a case of a railroad foreclosure. Certainly, the claim now pressed upon the attention of the court in the case at bar is akin to that presented to this court in the old case of Williams vs. Gibbs (*supra*), and is the very same as that asserted before and sustained by this court in the comparatively recent railroad foreclosure case of Union Trust Company vs. Morrison, 125 U. S., 591.

In the Morrison case the railroad company was in an insolvent condition and constantly harassed by suits. The Sheriff threatened to levy upon its rolling stock under an execution issued under a judgment against it in the State Court. To prevent such a result and to keep the railroad company going, a bill was filed in equity to enjoin the plaintiff in the State Court suit from proceeding to the collection of his judgment. An injunction was granted in the suit of the railroad company upon condition that the company should give an injunction bond with sureties for the payment of the judgment if the injunction should be dissolved. Morrison at the request of the railroad executed the injunction bond as surety. He was afterwards sued thereon and a judgment was recovered against him in September, 1880.

Morrison executed the bond as surety on or about the 30th of December, 1874, and in November, 1877, a bill to foreclose the mortgage upon the railroad was filed. After the judgment had been recovered against him as surety, Morrison intervened in the fore-

closure proceedings setting forth the facts just recited and asking to be protected from all the consequences of signing the bond upon the ground that by so signing the bond he had protected and preserved the property of the railroad company, and enabled it to continue a "going concern." The position taken by Morrison is stated in the words of Judge BRADLEY, at page 609 of the opinion, as follows: "THE GROUND OF THE CLAIM IS THAT A PORTION OF THE PROPERTY COVERED BY THE MORTGAGE, BEING IN PERIL OF ABSTRACTION AND LOSS, WAS RESCUED AND SAVED TO THE MORTGAGEE BY THE ACT OF THE PETITIONER."

The contention of Morrison was sustained by this Court, as establishing an equitable lien superior to the mortgage, for the reason that his act had saved the property for the mortgagee, and that the latter could not take his money and the direct benefit of the property saved and the indirect benefit of the railroad continuing as a going concern without reimbursing Morrison for the consequences of his act, done in behalf of the mortgagor, and at its request. The Court said, at page 609:

"It [the rolling stock] could have been taken, and this would necessarily have disturbed, and perhaps interrupted, the operations of the railroad, by separating the property seized from the corpus of the estate. The trustees of the mortgage might have prevented such a catastrophe, it is true, by filing a bill of foreclosure and for an injunction and Receiver; but they did not choose to take this course until nearly three years afterwards; *on the contrary, they allowed the railroad company to continue to use the property, and to take care of it for them, and stood by and saw Morrison (who had no interest in the matter) put his hands into the fire and rescue the rolling stock of which they were to receive the benefit—both directly, by receiving the property itself without*

contest or controversy, and indirectly, by keeping up the railroad as a going concern. Morrison's money, or the fruits of it, has gone into their pockets. And, in this regard, we make no distinction between the mortgagees, the bondholders, whom they represented, the nominal purchasers Horsey and Canda, or the present company. They were all one and the same in interest. If the property became justly affected by the equity of the petitioner's claim, it remains so affected in the hands of the present company." * * *

We respectfully submit that in the Morrison case this Court has recognized that the doctrine for which we contend is applicable to railroad foreclosure suits, and has directly approved the principle that an equitable lien superior to the mortgage arises whenever services are rendered which result in the saving and preserving the mortgaged property and keeping it a "going concern."

How infinitely stronger the equity in the present case is to that found in the Morrison case is quickly apparent from a comparison of the two cases. In the case at bar the rails not only accomplished the purpose of enabling the railway company to continue in business, but they actually became part, and a most important part, of the property itself, which has passed into the hands of the mortgagee, and also put money into the hands of the receivers as the result of the sale of the old rails replaced by those bought of the Lackawanna Company. In the Morrison case the result of the act of Morrison was simply to enable the railroad company to continue in business, and the services rendered by him did not result in the incorporation of anything into the property of the railroad company to be afterwards turned over into the hands of the mortgage creditors and their Receiver. In other words, Morrison, by signing the injunction bond and paying the judgment recovered against him,

simply placed the railroad in a position to continue in business, but in the case at bar the Lackawanna Company, by the sale of the rails, not only enabled the company to keep on as a "going concern," but directly added to the plant to the benefit of the mortgagee.

In *Burnham vs. Bowen*, 111 U. S., 776, the intervenor Bowen filed a petition in a foreclosure suit setting up that prior to the appointment of the Receiver therein coal had been furnished by the Northern Illinois Coal and Iron Company to the Chicago, Dubuque and Minnesota Railroad Company for running its locomotives, and asking that a judgment might be rendered in his favor against the railroad company for the payment of the amount due and that such judgment be declared a lien upon the property and road of the railroad company.

The coal was furnished in 1874 (the exact date does not appear), and the Receiver of the road appointed in the original foreclosure suit brought in the State court, and afterwards removed into the Federal court, was appointed in the month of January, 1875. A decree was entered in favor of the intervenor allowing his claim and directing a sale of the property if the claim was not paid. From this decree an appeal was taken to this Court, and the decree affirmed. In the course of the opinion of the Court, delivered by Mr. Chief-Justice WAITE, it was said at page 780 :

"In our opinion the view which the Circuit Court took of this case was the correct one. The company had never paid its bonded interest. From the very beginning it was in default in this particular, yet the mortgage trustees suffered it to keep possession and manage the property. The maintenance of the road and the prosecution of its business were essential to the preservation of the security of the bondholders. The business of every railroad company is necessarily done more

or less on credit, all parties understanding that current expenses are to be paid out of current earnings. * * *

"The business of a railroad should be treated by a court of equity, under such circumstances, as a 'going concern,' not to be embarrassed by any unnecessary interference with the relations of those who are engaged in or affected by it. * * *

*"The debt due Bowen was incurred to keep the road running, and thus preserve the security of the bond creditors. If the trustees had taken possession under the mortgage, they would have been subjected to similar expenses to do what the company, with their consent and approbation, was doing for them. * * **

"So far as anything appears on the record, the failure of the company to pay the debt to Bowen was due alone to the fact that the expenses of running the road and preserving the security of the bondholders were greater than the receipts from the business. Under these circumstances, we think the debt was a charge in equity on the continuing income, as well that which came into the hands of the court after the receiver was appointed as that before. When, therefore, the court took the earnings of the receivership and applied them to the payment of the fixed charges on the railroad structures, thus increasing the security of the bondholders at the expense of the labor and supply creditors, there was such a diversion of what is denominated in *Fosdick vs. Schall* the 'current debt fund,' as to make it proper to require the mortgagees to pay it back. So far as current expense creditors are concerned, the court should use the income of the receivership in the way the company would have been bound in equity and good conscience to use it if no change in the possession had been made."

The same important difference between the Morrison

case and the case at bar, to which we adverted in the consideration of the Morrison case, also exists between the Burnham case and the present case. The supplies furnished in the Burnham case were coal. It was presumably consumed before the Receiver of the railroad was appointed. Its only advantage and purpose and use, so far as the benefit to the railroad was concerned, was to keep it a "going concern." In the case now under consideration, the Houston and Texas Central Railway Company not only was kept a "going concern" by the rails supplied by the Lackawanna, but such rails became a permanent part of the roadbed and plant of the railway company, which was used by the Receiver, and we do not understand that the equity arising in favor of the materialman because he has kept the railway company a "going concern" by virtue of his supplies is in any way weakened by the fact that such supplies are in fact a permanent improvement of the railroad and are used by the Receiver in the conduct of its business.

The Burnham case as we read it was decided by this Court in exact accord with the doctrine of the cases other than railroad foreclosures to which we have referred the Court. That is to say, the ground of the decision was that the intervenor had an equitable lien for the coal against the railroad company because it preserved the property and kept it a "going concern," and that such lien was to be preferred to the prior mortgage for the reason that the mortgagee had practically made the railroad company its agent to create such lien. These may not have been the exact words used by this Court, but no other inference is to be drawn from the following sentence in the decision, "*the debt due Bowen was incurred to keep the road running and thus preserve the security of the bond creditors. If the trustees had taken possession under the mortgage, they would have been subjected to similar expenses to do what the company, with their consent and approbation, was doing for them.*"

In *Louisville, &c., Railroad Co. vs. Wilson*, 138 U. S., 501, the facts were these : The intervenor, Bluford Wilson, performed services as attorney for the Louisville, Evansville and St. Louis Railroad Company prior to the appointment of its receiver, and part of such service was rendered more than six months prior thereto. The service consisted in the recovery from the Illinois Midland Railway Company of certain engines leased to said company by the Louisville, Evansville and St. Louis Railway Company, and the rentals for their use. The allowance secured by Wilson was \$1,500, and of this amount \$1,340.13 was paid to the receivers of the Louisville, etc., Railway Company. Wilson claimed that his services were worth \$300 and the claim was allowed. This court affirmed the decree below in this respect upon the ground that the bondholders had been benefited by the service and ought to pay for it. Unless there is some material distinction, which does not occur to us, between furnishing brains and furnishing rails to a railway company, we do not see why this case is not a very strong authority in support of our position. In the opinion at page 506 the Court said :

“ The only testimony as to the value of such service fixed it at \$300. Part of such service was rendered more than six months prior to the appointment of a receiver in this case ; but, apparently, the important part within such time. *This recovery inured to the benefit of the security holders, as placing so much more money in the hands of the receiver for the purpose of discharging obligations against the company payable before the bonds. We think it may fairly be held that the party who takes the benefit of such a service ought to pay for it ; and that equity may properly decree payment therefor.*”

In *Union Trust Co. vs. Souther*, 107 U. S., 591, the

appellee intervened in the suit brought to foreclose the mortgage upon the Cairo and St. Louis Railroad Company, claiming that he should be paid for supplies furnished the railroad company prior to the appointment of the Receiver. The character of the supplies is not stated in the report of the case. The Court below directed the payment of the claim and its decision was affirmed by this Court, which said at page 594, after referring to certain paragraphs in *Fosdick vs. Schall (supra)*:

“To this we adhere, and, in our opinion, the right to impose terms does not depend alone on whether current earnings have been used to pay the mortgage debt, principal or interest, instead of current expenses (*Miltenerberger vs. Logansport Railway Company*, 106 *Id.*, 286). Many other circumstances may make such an order reasonable, and this case furnishes a striking example. The first default in the payment of interest under the mortgage occurred in October, 1873. *The bondholders did not see fit to take possession, as they had the right to do, when the default had continued for six months. On the contrary, notwithstanding no payments of interest had been made, they allowed the company to operate the road and incur obligations therefor until December, 1877. This was evidently in the hope that their condition would be improved by the delay; for to effect the forbearance they established an agency and incurred expenses to an amount much larger than the \$3,000 reimbursed by the company. Prior to the appointment of the receiver the gross earnings do not appear to have been enough to pay expenses, but afterwards they yielded a very considerable surplus. There cannot be a doubt that it was for the interest of the bondholders that the road should be kept in operation, and as they did not see fit to take possession while it could only be operated*

at a loss, it was certainly not an abuse of judicial discretion for the court to order, as a condition of granting their application for a receiver, that debts incurred by the company in thus protecting the security should be paid from the income of the receivership, if, in consequence of an increase of revenue, it could be done."

The reason of this decision seems to be that the bondholders "did not see fit to take possession" of the property, but left it in the hands of the mortgagor to be run by it in the usual way in which the operating affairs of a railroad company are carried on, and that the mortgagee having left the mortgagor in possession must be deemed to have authorized it to incur debts in the care of the property and that "debts incurred by the company in thus protecting the security should be paid from the income of the receivership."

The principle which we think should be applied in this case was referred to with approval in *Miltenberger vs. Logansport Railway Co.*, 106 U. S., 286, 311, where it was said by Mr. Justice BLATCHFORD:

"It cannot be affirmed that no items which accrued before the appointment of a Receiver can be allowed in any case. Many circumstances may exist which may make it necessary and indispensable to the business of the road and the preservation of the property for the Receiver to pay pre-existing debts of certain classes, out of the earnings of the receivership, or even the *corpus* of the property, under the order of the Court, with a priority of lien. * * *

"In case of non-payment [of debts] the general consequence involving largely, also, the interests and accommodation of travel and traffic, may well place such payments in the category of payments to preserve the mortgage property in a large sense, by maintaining the good-will and integrity of the

enterprise, and entitle them to be made a first lien"
(p. 312).

The doctrine that supplies furnished to a railroad, which save and preserve the property and keep it a "going concern," are to be paid ahead of the mortgage upon the ground that the mortgagee, by leaving the mortgagor in possession, impliedly authorized him to take care of the property, and to charge it with an equitable lien for any supplies furnished which were necessary in order to continue the road in operation and enable it to earn money to pay its mortgage debt, was again recognized and approved by this Court in the late case of *V. & A. Coal Co. vs. Central Railroad, &c., Co.*, 170 U. S., 355, the material facts in which were as follows :

The coal company had furnished coal to the Richmond and Danville Railroad Company for use upon the lines of the Central Railroad and Banking Company, of Georgia, which were under the control and management of the Danville Company. The contract was dated July 13th, 1891, and the time specified therein for the delivery of the coal was from July 1st, 1891; to July 1st, 1892. In March, 1892, a suit was commenced in the United States Circuit Court in Georgia to cancel the lease of the property of the Central Company to the Georgia Pacific Company and for other specific relief, and a Receiver was appointed upon the 4th of March, 1892. In this suit the coal company intervened and stated in its petition that the "coal was furnished to the Central Company for the purpose of being used by it in the running of its machinery and the prosecution of its business; that a great portion of said coal remained on hand in the bins and storage places of the Central Company at the time of the appointment of the temporary Receiver, and a large portion was still on hand when the Board of Receivers was appointed, and went into possession of said Receivers, and had since that time been actually used by the Receivers in the running of the machinery of, and

the operation of the business of, the Central Company", (p. 359).

After considerable litigation it was eventually decided by the Circuit Court of Appeals for the Fifth Circuit that the coal company was entitled to be paid the amounts due it "for coal delivered to the lines under the control and forming a part of the system of the Central Railroad and Banking Company of Georgia, as shown by the evidence in this cause, including the coal furnished before the appointment of the Receivers and that found in the bins of the line after such appointment, and of which the Receivers took possession."

The decision of the Circuit Court of Appeals was affirmed by this Court, and Mr. Justice WHITE, who delivered the opinion of the Court, after referring with approval to the decisions of *Burnham vs. Bowen*, 111 U. S., 776, and *Miltenberger vs. Logansport Railway Company*, 106 U. S., 286, said at page 367 :

"Is there any good reason why the equitable doctrine, applied in the cases to which we have referred, should not be applied under a state of facts such as shown at bar, where the immediate management of a road was confided by its owners, without protest or interference by the bondholders, to third parties? It would seem not. The dominant feature of the doctrine, as applied in *Burnham vs. Bowen*, is that where expenditures have been made which were essentially necessary to enable the road to be operated as a continuing business, and it was the expectation of the creditors that the indebtedness created would be paid out of the current earnings of the company, a superior equity arises in favor of the materialman as against the mortgage bonds in the income arising both before and after the appointment of a receiver from the operation of the property.

"The equity thus held to arise when a purchase

of necessary current supplies is made by the owning company, is not in anywise influenced by the fact that the company itself is the purchaser of the supplies, but is solely dependent upon the fact that the supplies are sold and purchased for use, and that they are used in the operation of the road, that they are essential for such operation, and that the sale was not made simply upon personal credit, but upon the tacit or express understanding that the current earnings would be appropriated for the payment of the debt. Clearly, if the owning company had entered into an agreement with some individual to commit to his uncontrolled management as their agent the operation of the company's lines, the bondholders could not be heard to say that thereby no equities could arise in favor of labor or supply claimants in the income of the property preserved or kept in operation by their efforts."

It is to be noticed that in the case just referred to the Court went one step further in the matter of agency than is required in the present case. In the Virginia Coal Company case it was held that the mortgagee was bound by the equitable lien created by the lessee of the mortgagor and that such lien was entitled to preference over the mortgage for the reason that the bondholders "without protest or interference" had allowed the owner to place the immediate management of the road in the hands of third parties. In the case at bar the lien was created by the Houston and Texas Central Railway Company, the mortgagor, which had been left in possession of the road and was therefore impliedly authorized to carry it on in a proper manner and in the usual way.

We know of no case in this Court which in any way conflicts with the principle which we now maintain and no decision which seeks to limit the doctrine as announced in *Fosdick vs. Schall*. It has been

sometimes said that the two cases of *Kneeland vs. American Loan Co.*, 136 U. S., 89, and *Thomas vs. Western Car Company*, 149 U. S., 95, were intended by this Court to limit the expression of opinion to be found in *Fosdick vs. Schall*, but as we understand the *Kneeland* and *Thomas* cases, they merely affirm what was the actual decision in *Fosdick vs. Schall* and express no opinion either for or against the so-called doctrine of that case. The facts in *Fosdick vs. Schall*, in the *Kneeland* case and in the *Thomas* case were essentially the same. In each the intervenor claimed payment for the rental of cars prior to the appointment of a Receiver, and in each case the intervenor had retained a vendor's lien upon the cars and had, therefore, apparently not relied upon any equitable lien for the enforcement of his rights under his contract with the railroad company. In each case the cars were returned to the intervenor or declared not to be within the lien of the mortgage, but the rental therefor, which was substantially the purchase price, was held not to be preferred to the mortgage. The contracts for the rental of these cars were in form leases, but were in fact contracts of sale and the so-called rentals were payments on account of purchase price, "with the right to retake possession on default in payment" (*Kneeland* case, 136 U. S., 89, 96).

The distinction between a car-rental case and the case at bar is too obvious for argument. The intervenor in the car-rental cases expressly protected himself by taking a specific lien upon his property and was able to retake it if the purchase money therefor was not paid. By reserving a specific lien upon the property at the time it was sold (which has always been preferred to the prior mortgage), he clearly indicated that he did not rely upon the intervention of a court of equity. It was also hardly to be expected that a court of equity would both return him his property, which he had furnished to the railroad, and then pay him for it also, which would have been the practical

result if such an intervention had been allowed. In other words, the cars were held not to be within the lien of the mortgage and the materialman was permitted to retake them. To allow him to take the cars and to then pay him for their value would have amounted to a double payment, for which there would seem to have been no equitable ground.

In any event it was apparently never intended by this court to limit the doctrine of *Fosdick vs. Schall* by these two decisions, for it was said by Mr. Justice WHITE in the *Coal Company* case (*supra*) at p. 371 that :

“ In neither the *Kneeland* nor the *Thomas* case was there any intention to question the prior decisions of the court, which allowed priority to claims based upon the furnishing of essential and necessary current supplies, not sold upon mere personal credit, against the surplus income arising during the operation of the road under the direction of a court of equity.”

In leaving this point we ask the same question which was asked by Mr. Justice WHITE in the *Coal Company* case at page 367, and respectfully submit that it would seem as if it should receive the answer which he gave thereto. This question, with a slight change made by us, shown by the italics, was :

“ Is there any good reason why the equitable doctrine applied in the cases to which we have referred should not be applied under a state of facts such as shown at bar, where the immediate management of a road was confided * * * without protest or interference by the bondholders to the railway company ? ”

IV.

THE PUBLIC HAVE AN INTEREST IN A RAILROAD, AND ANY REPAIR THEREOF WHICH TENDS TO PRESERVE SUCH PUBLIC INTEREST IS ENTITLED, BECAUSE OF ITS PUBLIC BENEFIT, TO A PREFERENCE OVER A PRIOR MORTGAGE.

The argument that a mortgagee, who leaves the mortgagor in possession of property, is deemed to have made the mortgagor his agent to carry on the property, and to create any lien thereon which may be necessary to keep it a "going concern," is far stronger in the case of a railroad company than in the case of a private concern because of the character of the property and the interest which the public has therein. The great value of a railroad company is, of course, its franchise, and in this the public has an interest, and, on account of this interest of the public, the courts have held that anything furnished to a railroad which keeps it a "going concern," and tends to enable it to retain its franchise must, because of the rights of the public which are thereby preserved, be entitled to be preferred to all private prior rights such as arise from the lien of a prior mortgage.

In *Barton vs. Barbour*, 104 U. S., 126, 135, the interest of the public in a railroad was referred to by this court as follows :

"The cessation of business for a day would be a public injury. A railroad is authorized to be constructed more for the public good to be subserved than for private gain. As a highway for public transportation, it is a matter of public concern, and its construction and management belong primarily to the Commonwealth, and are only put into private hands to subserve the public convenience and economy. But the public retain rights of vast consequence in the road and its appendages, with which neither the company nor any creditor or mortgagee can interfere. *They take*

their rights subject to the rights of the public, and must be content to enjoy them in subordination thereto. It is, therefore, a matter of public right by which the courts, when they take possession of the property, authorize the receiver or other officer in whose charge it is placed to carry on in the usual way those active operations for which it was designed and constructed, so that the public may not suffer detriment by the non-user of the franchises."

In *Olcott vs. The Supervisors*, 16 Wall., 678, 694, it was said :

"The railroads, though constructed by private corporations and owned by them, are public highways, has been the doctrine of nearly all the courts ever since such conveniences for passage and transportation have had any existence. * * * What else does this doctrine mean if not that building a railroad, though it be built by a private corporation, is an act done for a public use? And the reason why the use has always been held a public one is that such a road is a highway whether made by the government itself or by the agency of corporate bodies, or even by individuals when they obtain their power to construct it from legislative grant. * * *

"Whether the use of a railroad is a public or a private one depends in no measure upon the question who constructed it or who owns it. It has never been considered a matter of any importance that the road was built by the agency of a private corporation. No matter who is the agent, the function performed is that of the State. Though the ownership is private, the use is public."

In *Joy vs. St. Louis*, 138 U. S., 1, 47, the public character of a railroad was spoken of by Mr. Justice BLATCHFORD, as follows :

"Considerations of the interests of the public are held to be controlling upon a court of equity, when a public means of transportation, such as a railroad, comes into the possession and under the dominion of the court."

And again he said, at page 50 :

"Railroads are common carriers and owe duties to the public. The rights of the public in respect to these great highways of communication should be fostered by the courts; and it is one of the most useful functions of a court of equity that its methods of procedure are capable of being made such as to accommodate themselves to the development of the interests of the public, in the progress of trade and traffic, by new methods of intercourse and transportation (p. 50)."

The doctrine for which we contend in this case—to wit : that the lien for necessary supplies furnished to a railroad is superior to the lien of a prior mortgage for reasons of public policy has been and is constantly recognized by the courts in the administration of a railroad property when in the hands of its receiver. For supplies furnished to a railroad to keep it a "going concern" after the appointment of a receiver, the courts issue Receiver's certificates, and allow such certificates preference over the prior mortgage in the suit to foreclose which the Receiver was appointed.

In *Wallace vs. Loomis*, 97 U. S., 146, the doctrine of receiver's certificates issued to raise money for the preservation of the property in the hands of a Receiver was declared by Mr. Justice BRADLEY, at page 162, as follows :

"The receivers were authorized by the order appointing them, amongst other things, to put the road in repair and operate the same, and to procure such rolling stock as might be necessary ;

and, for these purposes, to raise money by loan to an amount named in the order, and issue their certificates of indebtedness therefor; and the order declared that such loan should be a first lien on the property, payable before the first mortgage bonds. The power of a court of equity to appoint managing receivers of such property as a railroad, when taken under its charge as a trust fund for the payment of incumbrances, *and to authorize such receivers to raise money necessary for the preservation and management of the property*, and make the same chargeable as a lien thereon for its repayment, cannot, at this day, be seriously disputed. It is a part of that jurisdiction, always exercised by the court, by which it is its duty to protect and preserve the trust funds in its hands."

In *Kneeland vs. Luce*, 141 U. S., 491, 509, the court said:

"Under all the circumstances of the case, the bondholders are precluded from claiming priority over the receiver's certificates, *which were issued for the purpose of preserving the mortgaged property*."

The close analogy between the principle that receiver's certificates for repairs necessary to keep up a railroad are always to be preferred to a prior mortgage, and the doctrine which we maintain, viz.: that such repairs prior to a receivership must also be preferred, because of the public character of the property and the interests of the people therein is well brought out in the case of the *Union Trust Company vs. Illinois Midland Company*, 117 U. S., 434, 462. Among other questions decided by this case, it was held that receiver's certificates for work necessary "in order to place the railway in a suitable condition for the safe transportation of business" were to be preferred to a prior

mortgage and the decision was based upon the cases of Fosdick vs. Schall (*supra*) and Burnham vs. Bowen (*supra*). The great similarity between the facts in the present case and the portion of the Union Trust Company case just referred to is apparent at a glance. In both the repairs were of a worn out road in order to make it safe for traffic. The court said at page 462 :

“ An affidavit annexed to the petition, made by the roadmaster of the Illinois Midland Company, states that, *in order to place the railway in a suitable condition for the safe transportation of business, the expenditure contemplated was absolutely necessary.* The commissioner finds that the money was expended in substantial compliance with the order of the court and that the improvements made by the receiver no more than made up for the deterioration of the road, *especially in view of its imperfect construction and inferior material from the beginning.* This finding was approved by the Circuit Court.

“ As to the certificates of the 18th series issued to replace earnings diverted from paying for operating expenses and ordinary repairs, to pay for betterments, while debts to a large amount had been incurred for the operating expenses and ordinary repairs, it appears by the petition of the receiver and the affidavit of the roadmaster annexed to it, on which the order of June 29, 1881, under which the certificates were issued, was made, that the expenditures for new side tracks and betterments so paid for out of earnings consisted principally of expenditures for roadbed, bridges, iron and ties, *which were in a worn out and insufficient condition.*

“ The commissioner and the Circuit Court rested the allowance of these certificates on what was said by this court in the case of Fosdick vs. Schall, 99 U. S., 235, 273, 254, which views were

applied in *Burnham vs. Bowen*, 111 U. S., 776, to the effect that, when the current income of a railroad in the hands of a receiver is diverted to the improvement of the property by the receiver, and debts for operating expenses are not paid, provision should be made, in foreclosing a mortgage on the road, to pay such debts out of the proceeds of the sale of the property."

It would seem, therefore, that the lien of the petitioners in the present case should be preferred to the lien of the prior mortgage upon the railway company's property not only upon the grounds stated in the authorities other than railroad cases to which we have called the attention of the court, but also because of the special doctrine invoked in railroad foreclosure suits; viz., that the public have an interest in the property superior to any rights of mortgagees, and that any work upon or repair to the property which was required to preserve such public right was entitled to be paid out of the income or out of the *corpus* of the property prior to the payment of any prior mortgage thereon.

V.

IT WILL SUFFICE FOR THE PURPOSES OF THIS CASE TO RECOGNIZE THE LIEN AS TO INCOME.

We have heretofore argued this case as if the question was whether upon the facts presented therein the petitioners have a lien upon the corpus of the property of the railway company, but it is a somewhat larger and broader question than necessarily arises here, for the fund now in court upon which the petitioners claim a lien and which is sufficient to pay their claim is the income earned by the railway company while in the hands of receivers and earned by reason and by the use of the rails furnished by the Lackawanna Company to the railway company.

Further than that it is to be observed that after these rails were furnished by the Lackawanna Company just prior to the failure of the railway company large sums of money far exceeding in amount this claim were diverted from the income and used to pay dividends to the holders of Waco and Northwestern Division First Mortgage Bonds and for the improvement of the mortgaged property.

When due weight is given to these considerations and to the fact that the circuit court has always with great care provided in every decree in the various litigations referred to in the statement of this case that such decree was to be without prejudice to the rights of these petitioners as against the income of the railway company it is very evident that the position of the petitioners as to such income is even stronger and more within the remedial power of a court of equity than their claim against the *corpus* of the property of the railway company.

This was the view of this Court in the case of *Fosdick vs. Schall*, 99 U. S., 235, when Chief-Justice WAITE in considering the question whether an "order for the payment out of the fund in court of the rent of the cars during the time they were used by the receivers, appointed by the State Court, and for six months before, [was] justifiable under the circumstances of the case," said at pages 251 *et seq.* :

"As to the second question, we have no doubt that, when a court of chancery is asked by railroad mortgagees to appoint a receiver of railroad property pending proceedings for foreclosure, the court, in the exercise of a sound judicial discretion, may, as a condition of issuing the necessary order, impose such terms, in reference to the payment from the income during the receivership of outstanding debts for labor, supplies, equipment, or permanent improvement of the mortgaged property, as may, under the circumstances of the particular

case, appear to be reasonable. Railroad mortgages and the rights of railroad mortgagees are comparatively new in the history of judicial proceedings. They are peculiar in their character and affect peculiar interests. The amounts involved are generally large, and the rights of the parties oftentimes complicated and conflicting. It rarely happens that a foreclosure is carried through to the end without some concessions by some parties from their strict legal rights, in order to secure advantages that could not otherwise be attained, and which it is supposed will operate for the general good of all who are interested. This results almost as a matter of necessity from the peculiar circumstances which surround such litigation.

“ The business of all railroad companies is done to a greater or less extent on credit. This credit is longer or shorter, as the necessities of the case require ; and, when companies become pecuniarily embarrassed, it frequently happens that debts for labor, supplies, equipment and improvements are permitted to accumulate, in order that bonded interest may be paid and a disastrous foreclosure postponed, if not altogether avoided. In this way the daily and monthly earnings which ordinarily should go to pay the daily and monthly expenses are kept from those to whom in equity they belong, and used to pay the mortgage debt. The income out of which the mortgagee is to be paid is the net income obtained by deducting from the gross earnings what is required for necessary operating and managing expenses, proper equipment and useful improvements. Every railroad mortgagee in accepting his security impliedly agrees that the current debts made in the ordinary course of business shall be paid from the current receipts before he has any claim upon the income. If, for the convenience of the moment, something is taken from what may not improperly be called the

current debt fund, and put into that which belongs to the mortgage creditors, it certainly is not inequitable for the court, when asked by the mortgagees to take possession of the future income and hold it for their benefit, to require as a condition of such an order that what is due from the earnings to the current debt shall be paid by the court from the future current receipts before anything derived from that source goes to the mortgagees. In this way the court will only do what if a receiver should not be appointed the company ought itself to do. For even though the mortgage may in terms give a lien upon the profits and income, until possession of the mortgaged premises is actually taken or something equivalent done, the whole earnings belong to the company and are subject to its control (*Galveston Railroad vs. Cowdrey*, 11 Wall., 459; *Gilman et al. vs. Illinois and Mississippi Telegraph Co.*, 91 U. S., 603; *American Bridge Co. vs. Heidelberg*, 94 Id., 798).

“The mortgagee has his strict rights, which he may enforce in the ordinary way. If he asks no favors, he need grant none. But, if he calls upon a court of chancery to put forth its extraordinary powers and grant him purely equitable relief, he may with propriety be required to submit to the operation of a rule which always applies in such cases, and do equity in order to get equity. The appointment of a receiver is not a matter of strict right. Such an application always calls for the exercise of judicial discretion; and the Chancellor should so mold his order that, while favoring one, injustice is not done to another. If this cannot be accomplished, the application should ordinarily be denied.

“We think, also, that if no such order is made when the receiver is appointed, and it appears in the progress of the cause that bonded interest has

been paid, additional equipment provided, or lasting and valuable improvements made out of earnings which ought in equity to have been employed to keep down debts for labor, supplies and the like, it is within the power of the court to use the income of the receivership to discharge obligations which, but for the diversion of funds, would have been paid in the ordinary course of business. This, not because the creditors to whom such debts are due have in law a lien upon the mortgaged property or the income, but because, in a sense, the officers of the company are trustees of the earnings for the benefit of the different classes of creditors and the stockholders; and, if they give to one class of creditors that which properly belongs to another, the court may, upon an adjustment of the accounts, so use the income which comes into its own hands, as if practicable, to restore the parties to their original equitable rights. While, ordinarily, this power is confined to the appropriation of the income of the receivership and the proceeds of moneyed assets that have been taken from the company, cases may arise where equity will require the use of the proceeds of the sale of the mortgaged property in the same way. Thus, it often happens that, in the course of the administration of the cause, the court is called upon to take income which would otherwise be applied to the payment of old debts for current expenses, and use it to make permanent improvements on the fixed property, or to buy additional equipment. In this way the value of the mortgaged property is not unfrequently materially increased. It is not to be supposed that any such use of the income will be directed by the court, without giving the parties in interest an opportunity to be heard against it. Generally, as we know, both from observation and experience, all such orders are made at the request of the par-

ties, or with their consent. Under such circumstances, it is easy to see that there may sometimes be a propriety in paying back to the income from the proceeds of the sale what is thus again diverted from the current-debt fund in order to increase the value of the property sold. The same may sometimes be true in respect to expenditures before the receivership. No fixed and inflexible rule can be laid down for the government of the courts in all cases. Each case will necessarily have its own peculiarities, which must be a greater or less extent influence the Chancellor when he comes to act. The power rests upon the fact that in the administration of the affairs of the company the mortgage creditors have got possession of that which in equity belonged to the whole or a part of the general creditors. Whatever is done, therefore, must be with a view to a restoration by the mortgage creditors of that which they have thus inequitably obtained. It follows that if there has been in reality no diversion, there can be no restoration, and that the amount of restoration should be made to depend upon the amount of the diversion. If in the exercise of this power errors are committed, they, like others, are open to correction on appeal. All depends upon a proper application of well-settled rules of equity jurisprudence to the facts of the case as established by the evidence."

VI.

THE RIGHT OF A MATERIALMAN TO BE PAID FOR SUPPLIES FURNISHED BY HIM TO KEEP A RAILROAD A "GOING CONCERN" IS NOT DETERMINED BY THE TIME WHEN THE SUPPLIES WERE FURNISHED PRIOR TO THE APPOINTMENT OF THE RECEIVER IN FORECLOSURE PROCEEDINGS.

The rails were delivered to the railway company by the Lackawanna Company in February, March, April

and May, 1884, and the first Receivers were appointed in February, 1885, so that less than one year intervened between the time of delivery of the rails and the appointment of Receivers. The petition of intervention of the Lackawanna Company was first filed on the 12th day of September, 1885.

That such a lapse of time is not considered a bar to an equitable lien of this nature is shown by the following cases :

In *Hale vs. Frost*, 99 U. S., 389, some of the supplies furnished by the intervenor Hale, Ayer & Co. were apparently delivered to the railway company as early as 1872. The Receiver was appointed in the foreclosure proceedings in May, 1875.

In *Burnham vs. Bowen*, 111 U. S., 776, the coal was delivered in the year 1874, but the precise time in the year does not appear. The Receivers were appointed in January, 1875.

In *Union Trust Co. vs. Morrison*, 125 U. S., 591, the injunction bond, the signing of which saved the railroad and kept it in existence, was executed in 1874 and the Receiver was not appointed until November, 1877.

In *Louisville, &c., Railroad Co. vs. Wilson*, 138 U. S., 501, part of the services were rendered more than six months before the appointment of the Receiver.

In *V. & A. Coal Co. vs. Central Railroad, &c., Co.*, 170 U. S., 355, the coal was delivered in monthly installments beginning July 1st, 1891, and the Receiver was appointed in March, 1892.

It will be observed from the statement of facts that ever since the Lackawanna Company filed its intervention in cause No. 185 on the 12th day of September, 1885, it has at all times had an intervention pending involving the rails delivered to the railway company under the contracts hereinbefore referred to in the matter of the Receivership of the Waco and Northwestern Division of the Railway Company in every phase which that litigation has assumed. It is also to be noticed that the Receivership ordered in Consoli-

dated Cause No. 198 has been continued concurrently with the Receivership in cause No. 227 down to the present time. Any intimation, therefore, of laches or that the Lackawanna Company has slept upon its rights is entirely disproved.

SECOND POINT.

The Farmers' Loan and Trust Company and the beneficiaries under its trust had no lien upon any of the earnings of the Waco and Northwestern Division of the Houston and Texas Central Railway Company which were collected by the Receivers in Causes Nos. 185 and 198 prior to the filing of the foreclosure bill in Cause No. 227. An amount of said earnings far more than sufficient to pay the claim of the Lackawanna Company was diverted under orders of court from the payment of current-income creditors to the payment of mortgage creditors, or to the improvement of the mortgaged property. The current-income fund, to the extent to which it was so depleted, will be restored out of the proceeds of sale of the mortgaged property, or out of the income now in the hands of the court.

Inasmuch as the allowance of a claim of the character of the one set up by the Lackawanna Company is one resting so largely in the discretion of the

Chancellor, it is important to show the nature of any conflicting claims upon the revenues of the defendant Railway Company, because if no conflicting claims exist, or if the conflicting claims be of a character not commending themselves to the Chancellor, they may be disregarded in the exercise of the judicial discretion allowed in such cases. That the mortgagee, under this mortgage had no mortgage upon income, is seen from a mere inspection of the mortgage (Rec., p. 14).

In the case of United States Trust Company vs. Wabash Railway, 150 U. S., 287, 306, where the mortgage did not cover income and was apparently in its terms similar to the mortgage in the present case, it was held that the mortgagee had no claim to income earned prior to its taking possession of the railway company's property. The court, speaking through Mr. Justice BROWN, said at page 306 :

"There is another reason, however, why the Trust Company is not entitled to the rental of this property prior to demanding possession thereof in its bill of foreclosure. The petition avers that, by reason of the defaults in the payment of the rentals, the receivers 'are indebted to your petitioner for the use and occupation of the said demised premises under the said lease.' But the mortgage or deed of trust to the Trust Company, the petitioner, did not purport to convey any of the incomes or earnings of the road, but provided that if default should, at any time, occur in the payment of interest, the trustee should, when requested so to do, take possession of the mortgaged property and operate the same and collect and receive all the tolls and income thereof. It was also provided that, until such default, the mortgagors should be entitled to have and to hold the possession of the railroad, and collect, receive and retain all the revenues arising from its use. * * *

"Now, if the mortgage had covered the earnings and rentals of the property, and those had constituted a part of the estate conveyed to the Trust Company as security for the bonds there would be some reason for saying that it would be entitled to recover these earnings and rentals in this action before it demanded possession of the road. But where the mortgage provides that the mortgagor shall remain in possession until default, but when default occurs the trustee may enter, this court has held that the trustee can only secure the earnings of the mortgaged property by taking or demanding possession."

Even if this mortgage had been a mortgage upon income, it would have given no lien upon the earnings of the road while it remained in the hands of the Company.

Railroad Co. vs. Cowdrey, 11 Wall., 459.

Smith vs. Railroad, 124 Mass., 154.

Gilman vs. Telegraph Company, 91 U. S., 603.

American Bridge Co. vs. Heidelbach, 94 U. S., 798.

The lien of a mortgage upon the earnings of a railroad depends solely upon its terms, and until the trustee takes some step authorized by the mortgage to appropriate the earnings no lien attaches to them.

Miltenberger vs. Logansport Railway Co., 106 U. S., 286, 307.

We quote passages from several of the decisions of this court stating the circumstances which determine the respective rights of the mortgagor and the mortgagee to the income of the property mortgaged.

In Dow vs. Railroad Company, 124 U. S., 652, this court stated the respective rights of the parties as follows at page 654 :

“ It is well settled that the mortgagor of a railroad, even though the mortgage covers income, cannot be required to account to the mortgagee for earnings while the property remains in his possession until a demand has been made on him therefor, or for a surrender of the possession under the provisions of the mortgage.”

In concluding the opinion, at page 656, it is further said :

“ Under these circumstance, *as there are no current expense creditors claiming the fund*” (italics ours) “ we are satisfied that the money is to be treated as income covered by the mortgages, and should be paid to the trustees, to be held as part of that security.”

The case of *Sage vs. Memphis & Little Rock R. R. Co.*, 125 U. S., 361, seems to us absolutely indistinguishable in principle from our case.

In that case a judgment creditor of the defendant company obtained the appointment of a receiver; that receiver was subsequently discharged, but only after a large amount of revenues had accumulated in his hands, which he was ordered to hold, subject to the orders of the court appointing him. Trustees of a mortgage of the railways of the defendant company, after the discharge of the receiver, and whilst he still held the income in his hands, filed a foreclosure bill, and also intervened in Sage's suit, claiming the income in the hands of the receiver. The Circuit Court recognized the claim and rejected Sage's demand to be paid out of said income. This Court reversed the decision of the lower court and ordered Sage to be paid in full.

In this case we have an exact duplicate of the *Sage* case, except that the income has been expended by the court for the benefit of the mortgage bondholders. That fact cannot affect the identity of principle between the two cases for two reasons ; viz. :

(1) Because *actus curiæ neminem gravabit* is a general principle of law ; and

(2) Because the court expressly reserved the rights of the Lackawanna Company in every order and decree which it rendered using the income ; so that the rights of that Company stand to-day just as they stood on September 12th, 1885, when it first intervened in the Southern Development Company Receivership (*i. e.*, Receivership in 185).

The Sage case is so exact a counterpart of our own that almost every line of the decision in that cause is applicable here. We nevertheless quote from it as follows at page 378 :

“ The trustees filed their bill of foreclosure June 26, 1883, but they did not intervene as trustees in this suit until February 23, 1884, some time after the discharge of the receiver and after the property had been surrendered to the company. Their claim and intervention shows upon its face that no part of the interest accruing upon the bonds secured by their mortgage subsequent to January 1, 1882, had been paid at the time they so intervened. By the terms of that mortgage it was provided that, in case of continuous default by the railroad company for thirty days after maturity in paying any of the sums specified in the interest coupons, the principal sums in all the bonds ‘ shall immediately become due and payable,’ and thereupon the trustees, upon the written request of the holders of a majority of said bonds, ‘ shall enter upon and take possession of all and singular the charter, franchises and property hereby conveyed, and shall and may sell the same to the highest bidder for cash in hand,’ etc. There was no moment pending the receivership when these trustees, upon the request of the holders of a majority of the bonds, might not have appeared in this suit, or in a separate suit in the same court,

and asked that the receiver hold for them as well as Sage, or that he be discharged and they put in possession of the mortgaged property, for the purposes of sale, pursuant to the mortgage. Neither they nor the bondholders elected to pursue that course. It may be that their action was dictated in part by the fact, found by the master, that the railroad, the principal security for their debts, was being largely improved during the receivership out of the income of the property, and that no part of that income was being diverted to pay Sage's judgment or the debts of the Company. If the trustees, pending the receivership, had intervened and asked possession of the property, they might perhaps have been entitled, as against general creditors, to the income of the property thereafter accruing, upon the principles announced by this court in *Dow vs. Memphis and Little Rock Railroad Co. (as reorganized)*, 124 U. S., 652. But we do not perceive any legal ground upon which they are entitled to the net earnings of the property, while it was in the hands of the receiver, in a suit instituted by a judgment creditor for the protection of his own interests, and not of the interests of the trustees, or of the bondholders, or of other creditors. His suit was, in effect, an equitable levy for his benefit, upon the net income of the property. Other creditors who filed their claims, based upon judgments, gain nothing, as between themselves and Sage, by the fact that their judgments were rendered upon coupons which were secured by lien upon the mortgaged property. Neither they nor their trustees, prior to the termination of the receivership, chose to assert this lien. Nor did they, pending the receivership, ask that the receiver should from and after their appearance hold for them as well as for Sage. They took action as simple contract creditors, whose

claims were reduced to judgment. If the bondholders, when intervening simply as judgment creditors, acquired an interest in the fund, they could not, upon any recognized principles of equity, deprive the creditor at whose instance and for whose benefit the receiver was appointed of his priority of right arising from the institution of suit for the purpose of reaching the income of the debtor's property. The judgments at law obtained by bondholders upon their coupons were all rendered after the receiver took possession of the property; some in the Spring of 1883, the larger part of them in October and November of that year, just before the receiver was discharged."

The action of the trustees, and of the bondholders in the Sage case, and in the Lackawanna case was identical.

Turning backward in the examination of the authorities we find *Kountze vs. Omaha Hotel Company*, 107 U. S., 378, *et seq.*, to be a most instructive case upon the principles now before the court for adjudication.

The *Kountze* case was an action on an appeal bond given for *superseatas* of execution on a decree of foreclosure rendered by the Circuit Court for the District of Nebraska, and the question was as to the measure of damages to be recovered on the bond. In determining this question it was necessary to determine whether or not the plaintiffs were entitled to recover rents and profits or damages for the use and detention, as it is otherwise called.

Upon this branch of the case Judge BRADLEY, in 107 U. S., 392, *et seq.*, said:

"And yet there is a material difference between the case of ejectment and a suit for the foreclosure of a mortgage.

"The difference is this: In ejectment the property of the land is in question, and if the

plaintiff has the right he is entitled to immediate possession, and to the perception of the rents and profits, which belong to him, and for which the defendant in possession is accountable to him. Every dollar, or dollar's worth, is so much of the plaintiff's property of which he is deprived. And the same is true in dower. But in the case of a mortgage the land is in the nature of a pledge, and it is only the land itself—the specific thing—which is pledged. The rents and profits are not pledged; they belong to the tenant in possession, whether the mortgagor or a third person claiming under him. This is not only the common law, but it is the express statute law of Nebraska, which declares that, 'in the absence of stipulations to the contrary, the mortgagor retains the legal title and right of possession.' The plaintiff in this case was not entitled to possession, nor to the rents and profits. His foreclosure suit did not seek possession, but sought the sale of a specific thing—the land. In such a case, until the litigation is ended, it doth not appear that there must be a sale, or even that the plaintiff is entitled to a sale. The defendant in possession is entitled to redeem the land until a sale is made, and until then he is entitled to the rents and profits which belong to him as of right. The taking of the rents and profits prior to the sale does not injure the mortgagee, for the simple reason that they do not belong to him. Waste—that is, destruction or injury to the land itself, as before stated—is an injury to the mortgagee. It diminishes the value of the pledge, and for such injury no doubt he might recover on the appeal bond. Other deteriorations, such as occur by want of repairs, accumulation of taxes, fires not covered by reasonable insurance, and the like, probably might also be fairly covered by the bond. But perception of rents and profits is the mortgagor's right

until a final determination of the right to sell, and a sale made accordingly."

See, also, *Teal vs. Walker*, 111 U. S., 242, where the Court, after announcing the general doctrine, further holds, that the case against the right of the mortgagee to recover rents and profits before foreclosure, is strengthened by the provisions of the General Statutes of the State of Oregon, to the effect that a mortgage of real property shall not be deemed a conveyance so as to enable the owner of the mortgage to recover possession of the real property without a foreclosure and sale according to law.

The laws of Texas are exactly the same upon this subject as those of the State of Oregon.

Article 1,340 of the Revised Statutes of Texas (see 1 Sayles' Texas Civil Statutes, p. 447) provides that :

"Judgments for the foreclosure of mortgages and other liens shall be, that the plaintiff recover his debt, damages and costs, with a foreclosure of the plaintiff's lien on the property subject thereto, and * * * that an order of sale shall issue to the sheriff or any constable of the county where such property may be, directing him to seize and sell the same as under execution, in satisfaction of the judgment, etc."

The Supreme Court of Texas, by a long line of decisions, the most noteworthy of which is the case of *Duty vs. Graham*, 12 Texas, 427, has expressly decided that, under this statute and under the laws of the State of Texas, a mortgage is a mere security for the payment of a debt. The mortgagor remains the real owner of the land and entitled to its possession, and the mortgagee cannot sustain an action of trespass to try title or ejectment against the mortgagor on the mortgage.

In the latest case decided by the Supreme Court of

Texas on this subject (*Giles vs. Stanton*, 86 Texas, 620, 627) the Court says:

“The Mortgagees under this mortgage had no lien upon the earnings of the road while it remained in the hands of the company. * * * The lien of the mortgage upon the earnings of the railway depended solely upon the terms of the mortgage, and until the trustee took some steps authorized by the mortgage to appropriate the earnings no lien attached to the earnings. * * * By the terms of the mortgage the company was to remain in possession of the road, and had the right to operate the same, and to appropriate the earnings and income. Upon default in the payment of interest continuing for six months, the trustee was empowered to take possession of the railway, and operate it, applying the net earnings to the satisfaction of the interest, or he might sue to foreclose the mortgage, and if such default continued for twelve months the trustee was authorized to sue to foreclose the mortgage. The trustee did not demand nor take possession of the road, and took no steps towards foreclosing the mortgage until the 18th day of June, 1891, when the plea of intervention was filed. It follows that the lien of the mortgage did not attach to the earnings of the road in the hands of the receiver which were earned before the date of the filing of the intervention, but from that time the lien of the mortgage attached to such earnings, subject to the expenditures and claims which by law were given a preference over it.”

By the terms of the mortgage sued upon in this cause, the Houston and Texas Central Railway Company was to remain in possession of its property, and had the right to operate the same and appropriate earnings and income until default, continuing for the time

stipulated in the mortgage, in which event the trustee was empowered to take possession of the railroad and operate it, applying net earnings to the satisfaction of interest. The trustee not only failed to take possession of the road, but never until it filed its foreclosure bill in Cause No. 227, took any steps whatsoever to assert any lien upon the earnings.

The provision of the mortgage that the trustee should take possession is, however, as above shown, absolutely worthless, under the laws of the State of Texas.

We, therefore, respectfully submit that the Farmers' Loan and Trust Company has never had the slightest title to the rents and revenues of the property of the defendant corporation, either before or since the filing of its bill of foreclosure in this cause, and we, therefore, conclude that the petitioners are the only persons before the Court having any claim to the income in question.

THIRD POINT.

If neither the Farmers' Loan and Trust Company nor the Lackawanna Company had any lien upon the earnings of the Waco and Northwestern Division of the Houston and Texas Central Railway Company collected by the Receivers in Causes 185 and 198 before the filing of the foreclosure bill in Cause No. 227, then that income should be distributed ratably between all the creditors of the railway company, and the Court, having diverted the earnings in question and devoted them

to the payment of the mortgage creditors or to the improvement of the mortgaged property, will, after reconstituting the current income fund to the extent to which it has been depleted, distribute the same ratably among the creditors of the defendant railway company now before the court—to wit, between the Farmers' Loan and Trust Company and the Lackawanna Iron and Coal Company.

If this court should conclude that the amount collected by the Receivers in causes 185 and 198 should be prorated between the creditors of the railway company who are parties to this cause, then it would seem that such distribution should be not upon the full amount of the mortgage debt, but upon the amount of the mortgage debt less the sum received by the bondholders upon the foreclosure sale of the property. That is to say, the basis of distribution to the mortgage creditors should be the amount of the deficiency judgment against the railway company at the foreclosure sale.

The principle of distribution which should control in this regard is that declared in *Wheeler vs. Walton & Whann Co.*, 72 Fed. Rep., 966, 967, where it was said :

“ Under an assignment for the benefit of creditors, which is virtually the case now before the court, a creditor holding notes of third persons as collateral security, by collecting those notes before a dividend is made, *must credit the amount collected upon the principal debt, and take a dividend upon the remainder only of the debt.* He cannot collect the collaterals and then claim a dividend upon the principal debt as it was at the time of the assignment.”

We do not know that the rule found in some cases in the lower federal courts that a creditor of an insolvent debtor cannot be required, in proving his claim, to allow credit for any collateral securities which he may hold, has any application to the present case. The situation here is that there is a fund in court to be equitably distributed between two claimants, and the question for the court to determine is what is the amount of each claim at the time the distribution of the money is to be made. In other words, the distribution of the fund in court is not to relate back and be as of the date of the first insolvency of the railway company, but is to be made upon the facts as they exist at the present time. That is to say, the mortgage creditors, having received a large part of their mortgage debt and being in fact only claimants of this fund to the amount which they failed to realize from the sale of the property are entitled to be paid a dividend only upon the amount of the deficiency judgment obtained by them.

Even if the rule that a creditor is not required to allow for collateral when proving his claim against an insolvent did have anything to do with the case at bar, it would seem that to pay the mortgage creditors a dividend upon the deficiency judgment only was the true and proper application of such rule, for, as we understand it, the meaning of the rule simply is that the claim proved, and upon which a dividend should be paid, must be the amount due the creditor at the time of the insolvency, which amount is, of course, not affected by any collateral held by such creditor. If before insolvency of his debtor the creditor had realized upon collateral held by him, he would obviously not be permitted to prove the amount of his claim without allowing credit for the collateral theretofore collected by him. In the case suggested the time for the determination of the amount of the claim dates from the act of insolvency, so here the time for the determination of the amount of the claims against this fund is

at the date of the distribution. Prior to that time the mortgage creditors received a large sum upon their mortgage debt. This sum should be credited upon their claim, and any dividend coming to them from the fund in court should, as it seems to us, be distributed upon the basis of their original mortgage debt, less whatever they have heretofore received on account thereof.

In determining this question it must not be forgotten that the court is seeking to make an *equitable* distribution of the money in its hands.

FOURTH POINT.

The Farmers' Loan and Trust Company and the beneficiaries under its trust have no lien upon the earnings of the Waco and Northwestern Division of the Railway Company which have been collected by the Receiver since the filing of the bill by said Trust Company in Cause 227 (present cause).

The mere filing of the bill of foreclosure in Cause 227, and the appointment of a Receiver therein, did not of itself create a lien in favor of the complainant upon all income thereafter earned by the property involved in such suit. As we understand it, the result, and the only result, of filing the bill and appointing the Receiver in Cause 227 was to place the property, and any income therefrom, in the custody of the court, to be by it equitably dealt with.

This was substantially the decision of this court in

Porter vs. Sabin, 149 U. S., 473, 479, where it was said by Mr. Justice GRAY, that,

“ When a court exercising jurisdiction in equity appoints a receiver of all the property of a corporation, the court assumes the administration of the estate ; the possession of the receiver is the possession of the court ; and the court itself holds and administers the estate, through the receiver as its officer, for the benefit of those whom the court shall ultimately adjudge to be entitled to it.”

In the case of Quincy, &c., Railroad Co. vs. Humphreys, 145 U. S., 82, 97, Mr. Chief-Justice FULLER stated the rule as follows :

“ They [the receivers] were ministerial officers appointed by the Court of Chancery to take possession of and preserve *pendente lite* the fund or property in litigation ; mere custodians, coming within the rule stated in Chicago Union Bank vs. Kansas City Bank, 136 U. S., 223, 236, where this court said : ‘ A receiver derives his authority from the act of the court appointing him, and not from the act of the parties at whose suggestion or by whose consent he is appointed ; and the utmost effect of his appointment is to put the property from that time into his custody as an officer of the court, for the benefit of the party ultimately proved to be entitled, but not to change the title or even the right of possession in the property.’ ”

In Davis vs. Gray, 16 Wall., 203, 217, the court held that :

“ A receiver is appointed upon a principle of justice for the benefit of all concerned. Every kind of property of such a nature that, if legal, it might be taken in execution, may, if equitable, be put into his possession. Hence the appoint-

ment has been said to be an equitable execution. He is virtually a representative of the court, and of all the parties in interest in the litigation wherein he is appointed. He is required to take possession of property as directed, because it is deemed more for the interests of justice that he should do so than that the property should be in the possession of either of the parties in the litigation. *He is not appointed for the benefit of either of the parties, but of all concerned. Money or property in his hands is in custodia legis.*"

Perhaps as good a discussion of this question as can be found in the reports is in the Virginia case of *Beverly vs. Brooke*, 4 Grat., 187, 208, where the court said :

" By means of the appointment of a receiver a Court of Equity takes possession of the property which is the subject of the suit, preserves it from waste or destruction, secures and collects the proceeds or profits, and ultimately disposes of them according to the rights and priorities of those entitled, whether regular parties in the cause or only parties in interest coming before the court in a seasonable time, and due course of proceeding, to assert and establish their pretensions. * * *

" The order of appointment is in the nature, not of an attachment, but a sequestration ; *it gives in itself no advantage to the party applying for it over other claimants.*"

The force of this argument would seem to be all the stronger when it is remembered that the mortgage in the present cause was not a mortgage of income, but simply of the corpus of the property of the railway company. Whatever may be the rule as to the effect upon the income of a railway property resulting from the filing of a bill to foreclose a mortgage which, by

its terms, is a mortgage of income, it would seem to be clear that, in the present case, where there is no mortgage of income, the mere filing of the bill to foreclose such mortgage cannot create a lien upon anything which was not covered by and included within the terms of such mortgage.

FIFTH POINT.

If the Farmers' Loan and Trust Company has no specific lien upon the earnings of the Waco and Northwestern Division of the Railway Company collected by the Receiver appointed upon the filing of the bill in Cause No. 227, then such earnings should be paid to the petitioners or should be ratably distributed between the petitioners and the Farmers' Loan and Trust Company.

If we are right in our position that the mere filing of a bill in a foreclosure suit does not confer a specific lien in favor of the complainant therein upon the income of the property involved in such suit (and we think we are), then the question which presents itself is which of the two claimants of the income earned in Cause No. 227 has the greater equity therein. Is it the Lackawanna Company, which a few months prior to the failure of the railway company furnished to it rails which were laid upon 30 miles out of 58 of the property foreclosed and which have earned the fund in court or is it the Trust Company, which has simply filed a foreclosure bill? It would seem as if the party who has furnished the rails which earned

the money in court had a claim thereon which was entitled to recognition before any claim arising from the mere filing a bill and placing the property in the hands of a receiver.

If, however, a superior claim to the fund in court arises in favor of the party who brings the property into the custody of the court by filing a foreclosure bill and placing the railway company in the hands of a receiver, then such superior equity in favor of the Lackawanna Company and prior in point of time to any such claim in favor of the Trust Company would seem to result from the intervention petition, which is substantially an ancillary bill, which was filed by the Lackawanna Company in Consolidated Cause No. 198 on the 26th day of November, 1886, and which is still pending and under which the receivership in said Consolidated Cause No. 198 was ordered to be concurrent with the receivership in this Cause No. 227.

It appears, therefore, that the petitioners are entitled to the income earned during the receivership in Cause No. 227 upon the ground (1) that even if neither the Lackawanna Company or the Trust Company have any specific lien upon the fund in court, yet upon the facts the equity in favor of the Lackawanna Company which furnished the rails which earned the money is the greater, and upon the further ground (2) that any priority arising from filing a bill and placing the property in the hands of a receiver appointed by the court is in favor of the Lackawanna Company which first filed its still pending intervention in Consolidated Cause No. 198, in 1886, some years prior to the filing of the bill by the Trust Company in Cause No. 227.

If the claim of the petitioners upon the income collected by the receiver appointed in Cause No. 227 is not entitled for the reasons just stated to be preferred to any claim thereon made by the Trust Company, then the two claims are to be treated as upon an equality, and

the income collected by the Receiver in Cause No. 227 should be ratably divided between them, the Lackawanna Company participating upon the basis of the unpaid bills for rails furnished by it, and the Trust Company participating upon the basis of the portion of the mortgage debt remaining unpaid after application thereto of the proceeds of sale of the corpus of the railway property.

It is not to be overlooked in the consideration of this case that the mortgage creditors have already sold the rails furnished by the Lackawanna Company and still unpaid for, and have by reason of such rails received a largely increased price for the entire property of the Waco and Northwestern Division. The question now before the court is as to a distribution of money earned by these very same rails. Is it equitable that the mortgage creditors should pocket both the money realized from the sale of the rails and the money earned by the rails prior to their sale, and that the Lackawanna Company should go unpaid?

SIXTH POINT.

The claim of the Lackawanna Company should be preferred to the lien of the mortgage involved in this cause or the fund in court distributed ratably among the creditors of the railway company.

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